BALANCING THE BUDGET

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BALANCING THE BUDGET

FRIDAY, MAY 29, 1981

U.S. SENATE,
SUBCOMMITTEE ON THE CONSTITUTION,
COMMITTEE ON THE JUDICIARY,
Phoenix, Ariz.

The subcommittee met, pursuant to notice, at 9 a.m., in the Maricopa County Board of Supervisors Chambers, Phoenix, Ariz., Senator Dennis DeConcini and Senator Orrin Hatch presiding.

OPENING STATEMENT OF SUBCOMMITTEE CHAIRMAN ORRIN G. HATCH

Senator HATCH. This hearing of the Constitution Subcommittee of the Judiciary Committee will come to order. I'm very pleased to be with you today in one of my favorite States, the State of Arizona, where I've spent a lot of time in recent years. I'm also very pleased to be with my good friend, Dennis DeConcini, who has been a pivotal leader in the fight for a constitutional amendment to require a balanced budget.

This amendment would have no chance if we didn't have this bipartisan support.

As you know, for the first time in history, this subcommittee reported out a constitutional amendment to require a balanced budget in December of 1979. Senator DeConcini played a major role in that, as did Senator Howell Heflin our Democratic Colleague from Alabama. We then went to the full Judiciary Committee. It was such a hotly contested issue; we lost nine to eight. Two of the Senators that voted against the amendment are no longer there. At least one of them lost as a result of statements he made concerning this amendment—indicating that he was the deciding vote on this particular issue—in front of the AFL–CIO. So, it is a volatile issue because 80 percent of the people want a balanced budget constitutional amendment.

We thought that was a good amendment then, but we have worked on it in conjunction with two of the large taxpayer groups in the country, the National Tax Limitation Committee, which, of course, wants to limit taxes and wants to limit the marginal tax rates from going up, and the National Taxpayers Union, which has been calling for a constitutional convention. and if 34 States call for a Constitutional Convention, then the Congress has no choice other than to call it. Thirty States have already called for a constitutional convention including, I believe, both Arizona and my State of Utah.

I might mention that they have done an excellent job in the National Taxpayers Union, and the National Tax Limitation Committee has done a tremendous job as well, and these two groups, I think, will be carrying this schedule all over America this year.

About 3 weeks ago, we passed out of the same Subcommittee on the Constitution a new amendment which was better than the one back in 1979 because it had a tax limitation provision as well, fought for by the National Tax Limitation Committee and agreed to by us. After a lot of anguish and a lot of work to refine the language, it then went to the full Judiciary Committee, and for the first time in the history of this country, a full committee passed out a constitutional amendment to mandate a balanced budget with a tax limitation provision in it, on a vote of 11 to 5. Two Senators didn't want to vote against it because they realized how serious this issue really is in the eyes of the people of this country.

We believe that this amendment, if we can continue to push it and if the taxpayers' support it there—we believe it will be—we believe that this amendment could be brought up before the end of this year, hopefully after President Reagan's program is enacted. And in the Senate, we believe we can win in the Senate. We have almost 50 cosponsors of this amendment right now, bipartisan cosponsors. Then we believe that it will be brought to the House of Representatives where it will be much more difficult to pass. It will be difficult in the Senate as well, but we think more difficult in the House.

One of the great salutary effects of this amendment is that, once a year, the people in this country will see who really is voting to break the budget and who isn't rather than having to shift through sometimes hundreds of votes during each year to figure out who really has been not prioritizing the spending practices of our Government and who has been busting our budget in this country.

As we brought out in our press conference, for the last 51 years, 45 of them we have had an unbalanced budget, and we have only had a balanced budget twice in the past 26 years. It's apparent that Congress isn't going to do much about it.

As a member of the Budget Committee in the Senate, I can tell you that we have anguished with this problem for a long time. Last year, it was announced in the Budget Committee in the Senate, on May 15, 1980, that we had the first balanced budget in 20 years. By the end of the summer, we were at least $30 billion in deficit. As we sit here in fiscal year 1981, better than halfway through the fiscal year, we're now sitting on a $60 billion deficit on budget and $23 billion in off-budget deficits, for a total of around $80, $83 billion in deficits.

I might mention also that, in 1979, some people have tried to make the point that legislation is the way to solve the problems, that Congress can police itself, and that, legislatively, we can do just as much as we can in this way. But in 1979, we passed the Harry Byrd amendment, legislatively, which requires a balanced budget in fiscal year 1981. As we sit here, we are $83 billion in deficit, if you include off-budget and on-budget figures. The off-budget figures, of course, aren't included in the $60 billion because the Congress, in its infinite wisdom, they set the off-budget catagory way out there so that they

don't have to include it. They can go out and buy more votes with that money.

Almost 78 percent of the Federal budget is what we call uncontrollable today because the Congress won't do anything to control it. When anybody tries, then you get all these political demagoguery statements back there that literally make it almost impossible to make any major changes.

What this amendment will do, more than anything else, is eliminate the biases in favor of high marginal tax rates, deficit financing, higher deficits and, of course, inflation, and increase the biases toward balancing the budget but allowing a safety valve to make the change during times of emergency, recession, depression, or war, by just having three-fifths of the Senate vote to overrule a balanced budget.

I might mention there is nothing unusual about that.

In the filibuster rule, which I have had to use on occasion, that requires three-fifths to invoke cloture. So, anybody could, on any budget matter not pursuant to the Budget Act, filibuster, anyway. So, we think that's a reasonable provision. It's a moderate provision. We had to fight a battle over whether it should be two-thirds, 70 percent, or three-fifths. We finally found it better to have three-fifths so it isn't too difficult during times of stress to be able to change it, but nevertheless a little more difficult than just a plain majority vote. On the rest of the votes pertaining to this particular amendment, a constitutional majority of 51 votes is essential, rather than 26, which can be enough to pass an amendment or a bill on the floor of the Senate ordinarily.

So, I'm pleased to be here. I want to compliment Senator DeConcini for the effort he's made in this regard. Without Senator DeConcini, I'll be frank to tell you, I don't think we would be as far along as we are, and I don't think we'd win this matter in the Senate. So, I particularly feel very close to him and feel that he has done an excellent job on this particular issue in the Senate. I particularly feel honored to be here in this State holding these field hearings so that we can start building the record in the field and the pressure across the country for this balanced budget amendment. Senator DeConcini.

Senator DECONCINI. Thank you. First, welcome to Arizona. Thank you for taking your time and thank you for making this one of your priorities. Senator Hatch is not only chairman of this subcommittee, but also chairman of the Labor and Human Resources Committee, and he has found time to consider this as a priority.

In the 5 months the Senate has been in session, we already have reported the bill out. The purpose of these hearings is to have field testimony that will be essential to our debates on the floor. It's not going to be an easy battle. I appreciate the chairman's leadership.

Mr. Chairman, due to the time schedule, I understand you must leave at 11, and we will make arrangements for that. I will ask that my statement be present in the record and we can proceed with witnesses.

Senator HATCH. Without objection, so ordered. We're very happy to have as our first witness today Mr. Paul Jones, senior vice president of Valley National Bank of Arizona. Mr. Jones, we appreciate having you here, and we appreciate the efforts you have made to share with us your viewpoint with regard to this amendment.

[Material follows:]

Opening Statement of Hon. Dennis DeConcini, a U.S. Senator From the State of Arizona

Mr. Chairman, I want to commend you for the prompt action you have taken in processing a balanced budget amendment to the point where shortly we will debate it on the floor of the Senate. The message that is rumbling throughout the land is "get the federal budget under control." The constituents of my State of Arizona make that clear to me; the people of the West make it clear to both of us; and President Reagan is certainly taking the difficult steps that are necessary to get federal spending under control. It is now either up to Congress through the traditional processes of amending the Constitution, or the States through a call for a Constitutional Convention, to reflect the clear will of the American electorate that we make balanced federal budgets the norm. I hope, Mr. Chairman, that unless the next few weeks raise substantial issues that require further consideration, a balanced budget amendment can be reported from the Senate as quickly as possible.

Last year I took the lead in pushing for a balanced budget amendment and this Subcommittee reported S.J. Res. 126. It was similar in purpose to the proposa we are considering today, S.J. Res. 58. Last year, we failed to report S.J. Res. 1126 by a single vote. This year it was a different story—we passed it overwhelmingly out of the Subcommittee and by a vote of 11–5 out of the Committee. It requires two-thirds vote of the members, or 67, to pass the amendment from the Senate to the House—and, I think we are going to get it.

This year's amendment is the product of compromise, and although it may not represent everybody's first choice as to how to balance the budget, it is a product that draws support from all sectors of the country that favor the concept of a balanced budget. It is the vehicle that embodies the most solid approach to a constitutional amendment and which has the best chance of final enactment. Very simply, the resolution states that "the Congress shall adapt a statement of receipts and outlays for that year in which total outlays are no greater than total receipts." Additional sections provide for exceptions to this principle in years in which a declaration of war is in effect, and establish a ratio between federal receipts and national income that has the overall effect of making this amendment not only a balanced budget amendment but also a spending and tax limitation amendment. The need for this latter factor cannot be overemphasized. In short, we elevate to the status of a constitutional principle the requirement that the federal government balance its budget and we do it in a way that is not only economically sound but also Constitutionally sound.

This is not a radical proposal. Over twenty state Constitutions either prohibit deficit spending or require their budgets to be balanced by the end of their fiscal year. At last count, thirty states had made application to Congress, in one form or another, for a Constitutional Convention to consider a balanced budget proposal. Four other states, Ohio, West Virginia, Missouri, and Washington are now actively considering making similar applications to Congress. If they do so, two-thirds of the States, or thirty-four, the number required to call a Constitutional Convention, will have been reached and Congress will have to face all the problems attendant to calling a Constitutional Convention. For many reasons I hope Congress obviates the need for a Constitutional Convention by addressing the issue forthrightly and quickly.

Although I prefer to balance the budget through the legislative process, regrettably, after observing Congress at work for the past four years, I am convinced that unless there is some constitutional discipline imposed, Congress will never by self-imposition follow a sound policy of fiscal prudence. We need an amendment to the Constitution to keep ourselves in check. In order to insulate the federal budgetary process from political pressures that would lead to deficits, a clear and binding Constitutional standard mandating the fiscal integrity of the federal government is needed.

The amendment of the Chairman of this Committee, Mr. Thurmond, cosponsored by Senator Hatch, myself, and others, has a general feature that makes it attractive to me and that is its aura of "Constitutionality." Although it will have very substantive results, in essence it is a procedural device that allows great flexibility. The language of S. Res. 9, is not overly detailed or filled with formulas and statistics, but rather sets forth the principle for a balanced budget in a clear and concise fashion using words that are used elsewhere in the Constitution and that have achieved well defined meanings. Mr. Chairman, I want to reiterate my support for the concept of an amendment to our Constitution to create a balanced budget. I shall support reasonable efforts such as S. Res. 9, to do so and urge that the Subcommittee act quickly on such a measure.

STATEMENT OF PAUL JONES, SENIOR VICE PRESIDENT, VALLEY NATIONAL BANK

Mr. JONES. Thank you, Senator Hatch and Senator DeConcini. The need to establish discipline in the federal budget is urgent. Lack of restraint has seriously damaged the economy. The proposal to impose discipline through Constitutional constraints would create a basis for significant improvement over the present system.

Elaborating on Senator Hatch's earlier comments, deficits have occurred in every year of the seventies and in 19 out of the last 20 years. Federal outlays in the last decade, including the offbudget agencies that Senator Hatch alluded to, have grown by 11.4 percent annually, considerably faster than the 10.3 percent growth in personal income.

Just to look at the current situation a little bit closer for a moment, in the first 6 months of the current fiscal year, spending aggregated almost $340 billion. People on the street who make the market for bonds and provide the outlets for mortgages are looking at a situation in which they expect at least that large a total in the second 6 months and expect us to end this current fiscal year spending at a monthly rate of almost $60 billion per month.

If those expectations turn out to be correct, the proposal for spending of $695 billion, the President's proposal for fiscal year 1982, certainly cannot be reached, giving rise to the concern that the budgetary deficit, despite the efforts that have been made during the current session of the Congress, will considerably exceed that estimate that is being talked about by the administration. Those fears, as reflected in the capital market, simply result in capital markets that largely do not function, and that as a result of not functioning do not provide the mechanism to finance the improvements that are needed to produce productivity in this country.

Historically, in order to finance these deficits, the Federal Reserve has sufficiently increased the money supply to keep interest rates consistent with the Federal's perception of a healthy level of economic growth. The effect has been a very rapid increase in the money supply. This has resulted in rampant inflation and declining growth in overall business activity.

Recently the Federal Reserve has been more concerned with controlling the monetary aggregates than interest rates. The result has been a prolonged period of stagnation, high and volatile interest rates, and low rates of real economic growth. The process of reducing inflation through monetary policy alone, without the assistance of sound fiscal policy, will continue to keep the economy weak and interest rates at historically high and volatile levels.

Had a constitutional amendment requiring a balanced budget been operative over the last decade much of the inflation that we're now experiencing could have been avoided. Federal spending, as a percent of the gross national product or national income, however you want to measure it, would have been smaller, perhaps the 20½ percent it was in 1970 instead of being 22½ percent or higher, where it is now. Inflation would have been lower; capital markets would not have been as crowded with Government financing needs; interest rates would have been lower and less volatile; and the ability of the economy to grow would not have been impaired.

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There are times when it's appropriate to run a deficit: during times of war and in times of extreme economic distress. Both of those contingencies are covered by the amendment.

Traditional economic analysis indicates that there is a tendency over time for there to be an imbalance between saving and investment. During expansions consumers tend to spend, to invest excessively. In recession savings become excessive. Consequently, the argument can be made that Government should act as a counterweight, running deficits in recessions and surpluses in expansions.

Government should have the ability to stimulate the economy during the times of acute recession, according to this analysis. However, to cure the abuses that have obviously arisen from this analysis, section 1 of the amendment is necessary. The requirement that at least 60 percent of the whole number of both Houses will be necessary for outlays to exceed receipts is a good amendment. There might even be some question as to whether 60 percent is high enough.

The provision should be used only as an escape valve; therefore, it must be very restrictive. It should only be for emergencies, in the event there is a need for substantial countercyclical policies.

Theories followed during the past 15 years, such as full employment budgets, have had pernicious effects that have been well-documented, and these must be eliminated. In the past 3 years, significant changes have occurred in the economic structure. Large segments of the economic system have been indexed to protect participants in the system against the widely expected continuation of rapid inflation.

Financial institutions currently are being deregulated, in part to alleviate periodic credit crunches which have occurred when market rates of interest have exceeded the maximum permitted under Federal price controls. Since late 1979, the Federal Reserve, as mentioned, has been attempting to regulate the money supply through controlling bank reserve, instead of attempting to influence reserves by setting interest rate levels.

As a result of the institutional changes that have been going on, shocks that were historically sustained by the real economy are now being borne by the financial system, by eliminating the mechanisms that cause credit crunches during which funds became unavailable at any price. Inventory cycles now appear to be less severe than they have in the past. The cost of money is being more relied upon as the inhibitor of activity, and availability of money is being relied upon less. Businesses and families seem less sensitive to interest rates and more sensitive to payment schedules. The net result is that financial instability is greater than in the past, and real activity seems more resilient at a rather stagnant level.

Under these new institutional arrangements, countercyclical policies may not be as necessary in the future. Yet, economics isn't an exact science. Consequently, flexibility continues to be an important ingredient; thus the escape valve of the proposed amendment is appropriate. Given the great excesses of the Federal Government during the last 15 years, the escape valve must be hard to open.

In the absence of section 2, there would be a risk that the budget would be balanced by increasing taxes, thus increasing the already highly punitive tax burdens that Americans, both individuals and

corporations, now have to bear. Additional tax increases would result in a further erosion of incentive and would impair our ability to build investment capital that is needed to compete in the world in which we exist today. Thus, restricting receipts and outlays to a percentage of the gross national product makes sense.

However, implicit in the bill is the assumption that the present level of receipts, as a percent of national income, is the correct level. It is not. Spending and taxing are clearly excessive. Some maximum level of spending and taxing—perhaps 20 percent of GNP—would be more appropriate and perhaps should be stated in the measure. The present level of taxation must be cut if we're going to stimulate growth in the real economy once again.

Section 4, which wouldn't allow Congress to pass on the tax burden to the States, is an essential element. We feel that this should be broadened to prevent the tax burden from being passed on not only to the States but also to any other Government subdivision, corporations, or individuals. The combination of sections 2 and 4, as they stand, would at least force the Government not to increase outlays as a percent of GNP or national income, and would, over time, mandate a cut in spending.

It is true; the proposal could cause some problems: expenditures on the so-called human resources have increased from 7.6 percent of the GNP in 1970 to almost 12 percent in 1980. Cutting back in this area will undoubtedly make it difficult for some politicians to buy votes by spending taxpayers' moneys.

Careful studies of the social program discussed indicate that much of the spending does nothing more than create jobs for the massive bureaucracies and its attendant consultants. The shift in employment from public, tax-supported payrolls to private sector is a one-time adjustment. It has to be made or we will all continue to suffer.

By making the shift, productivity will be improved and lower income groups will once again be able to aspire to improved living standards, rather than being doomed to becoming a pool of poverty whose votes are to be bought in a rather crass manner.

The present deficit is estimated to be about 8 percent of receipts. Businesses and families that have been in deficit have been able to break even by cutting spending. If individuals and corporations must live this way in this country, it's only right that Government must do so also. No expenditure is truly required to be made, even if it requires congressional action. Any element of the budget can be cut.

Senator Hatch has mentioned that 30 of the 34 States have approved calling a constitutional convention to consider a budget-balancing amendment. Although the need for reform is urgent, it could be preferable to let Congress take the action proposed in the amendment rather than reopening a constitutional convention.

It is true that the economic power of the United States is presently stifled. It can be brought back to its full potential. The proposed amendment is a necessary part of the political reform and an economic recovery program. It will take time to work out the present problems. The implementation of the proposed amendment would immediately improve expectations, and it would remove fears of further Government excesses. It would set the stage for a

resurgence of the economic strength in this country and would be a necessary element in providing for the renewal of growth in standards of living for all Americans. Thank you.

Senator HATCH. Thank you, Mr. Jones. We appreciate your testimony. You said in your testimony that this amendment eliminates the ability of Congress to "buy votes" with our tax dollars. Could you elaborate on that?

Mr. JONES. I think it's clear now that the dictum that I guess was first espoused in widespread form in the 1930's, that we ought to spend and tax and elect has been followed to the point that in the 1970's, the voter has been absolutely, and the taxpayer has been absolutely, decimated by the process.

There are more people who vote than there are who pay the taxes, and so it has been clearly advantageous for certain people to pose as friends of the poor by proposing to tax productivity segments of the economy and to transfer those streams of moneys to people who would vote on behalf of those particular people striving for public office.

But in the process, look what has happened. We have not provided the income for those people who were promised it. It's been largely spent on the bureaucracies and the consultants that surround Washington, D.C. So, the people intended to be benefited have been sadly fooled. The economy and those who pay taxes have suffered dreadfully.

We have taken those people who have produced and have worked and we have taxed them at ever-increasing rates. In the process we've impaired their ability to save and to invest and to provide for the productive investment capital that's needed to compete in the modern world in which we live. So, the result has been to impair the standard of living of every one and not benefit those who have been promised in the first place.

Senator DECONCINI. Mr. Jones, thank you very much for taking the time and your fine organization for putting together this thoughtful statement. I wonder if you could relate, just briefly, what you would anticipate if we were living under a balanced budget, either vis-a-vis this bill or the discipline that Congress has not been able to exercise in the past. We've certainly moved in the right direction, but we have not balanced the budget. How would that affect the banking industry, in your judgment? What would that mean, monetarily, in the immediate effect to banking institutions and the economy as it relates to your industry?

Mr. JONES. I think the result would be very positive and beneficial, not just for banking but for all of those people who are customers of banking; depositors and borrowers as well.

Senator DECONCINI. Do you think interest rates would rescind?

Mr. JONES. It would be a very positive influence on interest rates. I think the reasons are clear. As I mentioned in the prepared testimony, the fear of continuing out-of-control spending and deficits at the Federal level keep the capital markets impaired and decimated. It forced the Federal Government, only in the current month, to pay in excess of 15 percent for 2- and 3-year money; caused the Federal Government to pay almost 14 percent for 5-year money yesterday.

If the Federal Government is paying those kinds of rates of interest to obtain funds, there is no way that our customers can get loans to buy

houses, to put productive capacity into their businesses at affordable rates of interest because the rates being paid by the federal government set the base above which all the rest of us must pay.

If we were to have a balanced budget, by having the budget assure, particularly the investment markets, but all of us in fact, that we would have a sound fiscal policy, we would then have fiscal and monetary policy working in tandem to reduce the inflation and create stable financial markets.

Senator DECONCINI. What you're saying, the Government would not be competing to borrow that money to finance whatever the programs are, whether it's defense or food stamps?

Mr. JONES. Precisely.

Senator DECONCINI. Thank you. I wanted the record to be clear. I think you've laid it out quite explicitly, if we get the Federal Government out of this competition for those borrowed dollars, you believe the interest rates would subside substantially?

Mr. JONES. I think it would be a very positive influence leading to lower rates.

Senator DECONCINI. Do you also agree with the premise that psychologically it would have some benefit? It seems to me that if the Federal Government could show some years of fiscal restraint and real balanced budgets, it would have a psychological effect on everyone in this country.

Mr. JONES. Part of the present problem is that no one believes the Federal Government. So that the numbers, as they're discussed, are not accepted. People do not think they would work out as the administration and Congress say that they will. And they have good reason to feel that way, they haven't for years.

Senator DECONCINI. Even when we adopt the budget that sets the deficit lower than last year, they don't believe.

Mr. JONES. They have good reason. It always turns out to be substantially more. The spending total always seriously overruns.

Senator DECONCINI. You made a good point, in the last Congress, for about 3 weeks, Senator Hatch, a member of the Budget Committee knows more details, we balanced the budget, or at least we pretended to balance the budget for a short period of time.

I didn't think it was balanced, and a number of Senators agreed, but there was at least a majority that passed that resolution. I think Senator Hatch said that we're going to have a balanced budget, CBO said, "Hey, fellows, you're not playing straight." They were right, we weren't, and we have a $60 billion deficit.

Thank you, Mr. Jones. Thank you very much for your testimony today.

Senator HATCH. Thank you, Mr. Jones. We appreciate your effort here today. Our next witness will be Mr. Robert Robb, Vice President of Government Affairs, Arizona Chamber of Commerce. Thank you, Mr. Robb, for coming. We look forward to your testimony.

STATEMENT OF ROBERT ROBB, VICE PRESIDENT OF GOVERNMENTAL AFFAIRS AND PUBLICATIONS, ARIZONA CHAMBER OF COMMERCE

Mr. ROBB. Thank you, Senator Hatch, Senator DeConcini. I must tell you that this is a rather unique opportunity for me: to

testify on a piece of legislation after the vote has been taken, and knowing that my side has prevailed.

Senator HATCH. The key votes are yet to come.

Mr. ROBB. I was told when I got into this business 5 years ago that the smart lobbyist always knew what the vote was before he got up to speak. I must confess to you, this is the first time in my career that I've truly felt like a smart lobbyist.

Mr. Chairman, Senator DeConcini, the Arizona Chamber of Commerce supports the constitutional amendment requiring a balanced Federal budget, and we can support the specific approach taken by Senate Joint Resolution 58 as recently passed by the Senate Judiciary Committee.

We support the constitutional requirement for the balanced budget for a number of reasons. Without question, the size of recent Federal deficits has unleashed inflationary pressures. Federal borrowing and credit assistance programs now usurp 35.7 percent of the American credit market. The combination of inflationary pressures and the usurpation of private credit markets has contributed significantly to our decade of economic stagnation.

This, of course, argues for a balanced budget in the current situation. The argument for a constitutional amendment requiring a balanced budget—except upon an extraordinary vote of Congress—is more complex and much more important.

Since the New Deal, Congress and the Fed have regarded it as their duty to fine-tune the American economy. It became obvious during the merry-go-round of economic policy during the 1970's—today we fight inflation; tomorrow, unemployment and stagnation—that the fiscal and monetary tools available to Government policy-makers are too imprecise to be useful. Indeed, confusing inconsistent attempts by Congress and Fed to fine-tune the economy have been the major economic problem this past decade.

There can be little doubt that the American people support a limit on Congress' ability to run deficits—for whatever reason. The Arizona Legislature is one of 31 that have called for a convention of the States for the purpose of drafting an amendment similar to that passed by the Senate Judiciary Committee.

The Arizona Chamber of Commerce supported Arizona becoming one of the States calling for a constitutional convention for this purpose.

Senate Joint Resolution 58 would not, of course, prohibit Congress from deficit spending. But it would make it tougher, and that is for the good. Section 2 will also protect against the budget being balanced through tax increases rather than through spending reductions.

Although we applaud the action of the Senate Judiciary Committee in approving Senate Joint Resolution 58, and hope it continues to make progress, it is not the complete answer to our economic problems. Equally important are efforts to reduce Federal spending.

In the past 3 years, Arizona has imposed constitutional spending limits on all levels of Government here. The Arizona Chamber has been a leading advocate of these limitations. The problem nationally is the same one we faced here: public expenditures absorbing an ever-increasing portion of the available economic resources.

In the last two decades, Federal spending has increased from approximately 18 percent of gross national product to approximately 23 percent. Congress should also refer to the States a constitutional amendment limiting Federal spending to a point below the present level. While section 2 of Senate Joint Resolution 58 would limit future increases, it does not reduce the economically debilitating increases that have already been incurred.

Balancing the budget must also not be used as an excuse for forgoing needed tax reductions, such as proposed by President Reagan. There is significant evidence that attempting to balance the budget without sizable tax reductions, would fail, even if spending is cut beyond the reductions tentatively approved by Congress in its recent budget resolution.

Present tax loads deter individual and corporate risk-taking by swiping the rewards from it. Risk-taking is the essential ingredient of economic progress. Present tax loads also deflect much economic activity toward unproductive tax shelters, and even further underground. Tax reductions are a necessary part of balancing the budget.

Neither of these two ancillary points, however, dilute our support for Senate Joint Resolution 58. We applaud the Senate Judiciacy Committee for passing it and hope that it prevails in Congress. Thank you very much.

Senator HATCH. Thank you. Let me ask you this: If we can get this amendment to the full Senate by the end of this year, can your organization do anything to spread the word about it through the grassroots of this county?

Mr. ROBB. Mr. Chairman, we certaintly will do our part. We are fortunate to have a very fine delegation in Congress, most of whom will support this approach. We will work through the federation system of chambers of commerce to urge other chambers of commerce to also support the approach.

Senator HATCH. As I understand it, there is not one member of your delegation that does not support a constitutional amedment to mandate a balanced budget?

Mr. ROBB. Mr. Chairman, I do not know whether that is true, but I wouldn't want to dispute it. I certaintly hope it's true.

Senator HATCH. Senator Goldwater, for instance, has been supportive of tihs type of amendment since he has been in the Senate. He has cosponsored Senate Joint Resolution 58, along with Senator DeConcini and myself.

We're hopeful that we can get organizations like yours to get out across the country and help people understand the amendment. It's relatively simple, but constitutional amendments, by necessity, have to be scrutinized with maximum care.

The thing I like about this amendment more than anything else is that it doesn't intrude unnecessarily in the legislative process. This is an amendment which eliminates structural biases toward spending in our present political process. We feel that this probably has the best chance of passage.

That's why I think we have such broad bipartisan support for this amendment.

We appreciate your testimony today and ask for your support.

Mr. ROBB. Thank you.

Senator HATCH. Senator DeConcini.

Senator DECONCINI. Thank you, Mr. Chairman. I thank you and the chamber. Orrin, I'd like you to know that the chamber has been a moving force in this State on a number of issues, and has been effective outside our State. They studied the equal access to justice bill that was passed last year in Congress, and they brought it back here and even improved on it in the State of Arizona, due to the hard work of Mr. Robb and the chamber.

Bob, let me ask you, is the chamber in any kind of a position to do any public education? I'm supportive of this amendment, obviously, but it needs to be explained because sections 1 and 2 approach it a little differently. I wonder if there is any plan of the chamber or if the chamber could consider some kind of program once the measure starts to move on the Senate floor, of a public information program that could explain exactly what it is and what effect it might have on the working person and the taxpayer in the State of Arizona.

Mr. ROBB. Senator DeConcini, certainly we can and will do that. We will disseminate the information to our members and urge them to contact their employees, which is an underutilized source of communication in this country. However, I do believe that the American public is behind you and understands the need for a constitutional amendment balancing the budget and also would support this particular approach.

It has sufficient flexibility to assuage any concerns people might have about the ability of Congress to respond in an emergency. At the same time it has protections against what I think people fear; an attempt to balance the budget through increasing taxes rather than through reducing spending. I think the approach is very well developed and will be fully supported by the American public.

The education campaign, I suspect, needs to take place among your colleagues in the Senate.

Senator DECONCINI. The reason I ask about it is that once it is seen that it may become a reality, I anticipate some stiff opposition from some segments, and they will have organizations and some, resources. I think it's going to be incumbent upon us to be able to realize that organizations such as the Arizona Chamber are prepared to do their bit to keep that public support because I think that's what is going to pass this, if it ever passes.

Mr. ROBB. Mr. Chairman, Senator DeConcini, I think your fear is very well grounded, as evidenced by the opposition that came forward when it appeared that the States would achieve sufficient numbers for the call of the Constitutional Convention. There were a number of points of opposition raised, some having to do with the procedure, but also having to do with the substantive arguments related to a constitutional amendment requiring a balanced budget. Certainly we support the economic theory and intent behind the amendment and will do everything we can to counteract any opposition that arises.

Senator DECONCINI. Thank you, very much, Mr. Robb. Mr. Chairman.

Senator HATCH. Thank you, Mr. Robb. We appreciate your effort. We've found the chamber to be always very supportive. We've had to balance a lot of factors here. Some people would like it to be much tougher; others want to add a two-thirds vote, or at least a 60-percent

vote, with regard to increasing taxation. We have kept a constitutional majority, 51 Senators, and that is not easy to get.

I think we have come a long way on this issue. We appreciate people like yourself who have put forth so much effort.

Mr. ROBB. We appreciate your efforts.

Senator HATCH. Thank you. Our next witness will be Mr. Melvin Morris, executive director, Arizona Tax Research Association, in Phoenix, Ariz. We are looking forward to hearing from you Mr. Morris.

STATEMENT OF MELVIN MORRIS, EXECUTIVE DIRECTOR, ARIZONA TAX RESEARCH ASSOCIATION

Mr. MORRIS. Thank you for the opportunity. I'd like to add that I am also chairman of the Western States Taxpayers Association, and the Utah, Nevada, Wyoming, and Montana Taxpayers Associations have asked that they be added as endorsing what I am about to give you.

Senator HATCH. I'll be happy to do so. Let the record so note.

Mr. MORRIS. This is all going into the record and I'll have mercy and skip through it rather than reading it all to you.

I think we all know if we had binding restraint mechanisms, for citizen initiative to put it in, we would have had it quite some time ago. Arizona has indicated it by 78 percent of the voters approving a 7-percent personal income limitation for the State, and that is exactly the approach you people are taking here. And then 2 years later 83 to 85 percent of the voters approved limitations on local government.

But the key to the whole dissertation, throughout all of those debates, most people want to know how can we limit the Federal Government? So, I think that many of the people have already expressed their views, I think it will just be extended in support of your efforts.

The revolt that we have seen nationwide is really a vote against the total of taxes and the majority of those taxes are Federal. As we have seen, taxes are taking an increasingly disproportionate part of our earnings. The various constitutional and statute limitations proposed and enacted in the State are, at best, an imperfect approach.

They're imperfect because they just, just by their very nature, have some flaws. Therefore, I want you to know that we will all be picking at whatever you're proposing, saying we would like to also have, but we also recognize that you must have some shortcomings because you end up with a bartering and trading in order to get a measure before the various States.

The States have been working for about 15 years or more. We've had measures go in and out, and we've changed and adjusted and started all over again. This is possible at the State level because the change of the Constitution is much more immediate, and this is not available at the Federal level.

Therefore, we urge you to be as careful and considerate as possible in what you put in. The trial and error kind of thing that we have done is not available to you, but what is available is that you can benefit from the errors that we have made. We can't possibly tell you what is best because, frankly, I don't begin to comprehend the intricacies of Congress.

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Senator HATCH. If it's any consolation, neither do any of us.

Mr. MORRIS. We've had the trial and error, and we know the ways that people get around them. We have not had deficit spending, however, and therefore we realize your problem is even greater because you must not only come up with ideas of taxing limitations but you must come up with ways of counteracting the problems that have been created by deficit spending.

Now, I am submitting a statement from the National Taxpayers Conference. I was a member of the committee that prepared it. It was prepared 2 years ago in support of—generally—the concept of limitations, without reference to specific points.

Senator HATCH. This little blue book?

Mr. MORRIS. Without any reference to specific points.

Senator HATCH. Without objection, we will put that in the record also.

Mr. MORRIS. Now, when we were reviewing that we found what you have already alluded to, that there have been numerous instances where Congress has put into the law statements that ultimately became policy statements. In the 1978 Revenue Act, they were going to tie everything to the gross national product, starting at 21 percent in 1980; then it would slightly reduce. In Public Law 96–10, section 6, they had it again. These things have been repeated. They've merely been policy statements that have been ignored. So, policy statements simply won't do the job. Binding language is needed and needed both for Congress and for the President.

Therefore, we suggest that originally, and I think the idea still is valid, that whatever you enact, whatever you're giving to the States you should also put it into the Congressional Budget Act so we'll have a chance to see how attentative the legislators are being on this.

As I see it, it would be 3 to 4 years before we actually get a limitation. I think we need it more immediately before that. Therefore, if we can also get a proposal into law, I think it would speed up the processes of selectivity that you have referred to here earlier.

Any budget limitation or spending limitation that you put in must have some limitations on what is an emergency. I think your measure, as it is now written, does exactly that. But I don't hold that necessarily what is in here now you're going to finally end up with. So, therefore, let me say that I think that the emergency should be defined clearly, either by procedure for declaration of the emergency or by preconceived limitation on what is an emergency. National defense, we would all agree, would qualify. After that, the opportunity for consensus of definition fades.

We believe that all emergencies, including war, should have a limited life, say, 1 year. I say 1 year on war because of what happened in Vietnam. If it is necessary to go beyond 1 year, it should require the President and Congress to reaffirm that an emergency still exists. I think that we want the President involved in declaring that there is an emergency—which was not in the resolution as it is now written—because I think we need both branches, the executive and legislative, to agree that this does this. We think both Houses should have to agree by a greater than simple majority.

Second, a base has to be determined. Now, I agree with the base that you've used, although the prior approach in Congress has been

on the gross national product. A thorough review needs to be made of exactly what is personal income and how is it determined, and this seems to be the entire process, because as we have discovered at the State level, after you start using some of these indexes that there are things in there you're not aware of, and there are some problems that evolve later because of what is included or excluded.

I think the experience with the Consumer Price Index will illustrate most clearly why I am dubious about just going out and accepting any base, whether it's GNP or personal income. The CPI has been used, for instance, in adjusting social security. Now, one of the major components of that is the medical, and yet medicaid and medicare pay the bulk of the costs for those people on social security. So, we're not only increasing what we're paying them but at the same time we're also paying those costs.

The same thing is happening with the CPI and labor contracts. It is one of the major factors, I think, in inflation because in the bulk of contracts these days, the medical costs are paid by employers through the medical insurance programs and so on. Yet if they include the CPI as an automatic adjustment on their labor contract, they are double-dipping, in effect, on those costs.

The mood of the Nation, as we all agree, is clearly in support of a constitutional limitation. While the States are being asked to ratify or reject the amendment, the concept should be put into law, then we will have a chance to see. Careful consideration should be given to define what is subject to limitation. It is our belief that both the unified budget and off-budget entity should be limited. I believe you're doing that now. I think you'll have some arguments as you go along; that's the reason I'm reenforcing that statement.

We think the citizens want a limitation which will work and which will be honored. It has been our experience that creative legislators and budget experts can find ways to defeat most limitations; that is the reason most States with limitations have had to try several before they obtain one they believe will work.

Now, the limitations that we have at present, they're primarily in western States, they're close to the citizens and the citizen input is there. Wherever there is abuse, we have a chance to respond. This will not be possible with the Federal limitations. You will not have the monitoring groups, such as taxpayers associations, chambers of commerce, which police these acts at the State level and local level.

Therefore, one of the problems I find with yours—not just yours, with all of them—is that it's very nice to say, but what happens if they do not? There is really no policing in this, and I think that we should be aware that that is the case. There is a very good chance that in many instances the constitutional amendment may not be observed any more closely than has been the policy language. I think we will be misleading people if we let them think otherwise.

If you give us what seems to be a limitation to pacify the taxpayer, but leave loopholes which your fellow legislators can use to neuter the limitation, then you will be increasing citizen distrust and unrest at a time when we need to improve citizen respect for government.

Limitations are not expected to make it easier on Government spenders. They're intended to force some priority decisions so that available money will be used to the best advantage.

Now, there is a major flaw, in my opinion, in Senate Joint Resolution 58 in that through article 2 it assumes that the present level of taxation is acceptable. Mathematically, if you run it out and if you're saying they can only increase as the percentage of income increases, you're saying if you put this in at 22.4 whatever it happens to be you're going to continue that.

It is my belief that what most people want is the reduction.

Senator HATCH. I think that you're right. However, with respect to that particular point, the reason that we did it in that way is because growth in Federal Government spending has always greatly exceeded the growth in the economy. If we could get them to accept the standard of proportionate growth, and acknowledge that the Federal Government is going to grow, it would be a major step forward. It is one of those classic compromise situations, where if you play too toughly, you can get into a lot of trouble. Look at what President Reagan is experiencing right now. He will be cutting $44 billion off the budget if he gets his way. Between 1980 and 1981 we increased revenues to the Federal Government by $100 billion, with various revenue programs pushing people into higher and higher marginal tax brackets.

President Reagan didn't even cut the budget in half and yet he was reproached by the liberals—from both parties, by the way—who have used the dodge that he's "taken food out of the mouths of the poor." And the 1982 budget will be more than 1981's; 1983's more than 1982's; and so on.

This is one of the things that we have tried to resolve. You have made a good point: Some of us would like it to be a little stronger.

Mr. MORRIS. Let me say this would be greatly superior to what we have now. We're working more days for the Government every year.

Senator HATCH. Many of us don't disagree with you.

Mr. MORRIS. I'm aware of these tradeoffs, but in the optimum it would move back slightly every year.

Senator HATCH. On the other point that you have made with regard to enforcement, we have had witnesses who believe that we should allow the courts to enforce, but we have had substantial contrary opinion, as well. The enforcement of this amendment will be at the polls, in our opinion. That's probably the best enforcement mechanism that exists anyway. The trouble today is that voters don't know who is breaking the budget and who isn't because of the large number of votes that we have on spending and taxing issues. So, this amendment would help them to make that choice much easier.

Mr. MORRIS. You see, you're working with a different kind of tax base than we are at the States. We have property taxes which is a balancing. We can set a tax rate to raise a precise amount of money. So, I see some problems no matter what you do on this. And my concept is that you probably, should go into how you're retiring some of the debt. I think that you are going to have to come up with, probably in law not in Constitution, some statements that if the economy is surging and you are getting more money in then you have to put through in your initial resolutions that, rather than being spent, because our experience has shown that in subsequent years legislators

come in and appropriate money for a prior year because the space was available, that that money rather should go to retire some of the debts. In other words, I think we need to see something clearly that is indicating how we're going to start reducing some of the debt.

The section that says if Congress mandates expenditures on the States, they should provide funding, in my opinion, does not go far enough. It should also include the courts. I only need point to what happened with the busing. There have been innumerable instances where very major expenditures have been passed on through other decisions. Since those were Federal Court decisions, I think this is an area of great concern to all of us.

And in section 4, the term "activities," I don't know, in my opinion, activities is a very vague word. I would hope that you'd find one that is a little more specific than that, because generally, in dealing with these budget limitation measures, what you can expect is you will find a lot of law going through Congress saying, as "to article so and so, section 4, this is not an activity."

This is exactly what the California Legislature did when they were mandated. They were putting the cost on local government, they were supposed to provide the funding. They took care of it by saying . . . You have one or two of those people in your legislature who were doing this kind of thing.

My final concern is the enterprise fund such as social security and highways, so on. I don't really see, because I don't understand your system as well, I don't see how those are limited. I think they should be. Although we have said off budget and on budget, soon, I'm not sure, that some of these things that are created as separate enterprises, I'm not sure they would be limited.

If they are not, that is the other thing I think you can look forward to, that you will see the creative legislator will start creating these entities which will be a way of raising money and spending money, either off payroll taxes or other things.

Senator DeConcini. Excuse me, Mr. Chairman, Mr. Morris, you're leaving an impression that, I think, is worthwhile pursuing. What you're saying is that Congress, in its expert way of handling laws, will find some way to get around this. So, you're suggesting that we ought to plan on that and try to end run it or stop it. You are suggesting further that more offbudget items, or some other way of financing programs might be innovated by a Congress who didn't want to live by this. It's a very good point, Mr. Chairman.

Mr. Morris. We have that experience at the State level.

Senator DeConcini. I was just going to ask you, have you seen that, have you witnessed that?

Mr. Morris. Let me give you some examples. For instance, we have limitations on schools. One of the exemptions was for adjacent ways; in other words, the streets and so on. We found that adjacent ways contracts, because they were outside the limitation, they started putting in a sidewalk and curb, it just kept going. When they were through it included the playground that they had paved, it included the area for the shops, you know.

Senator DeConcini. Was that ever the original intent?

Mr. Morris. No, now, this doesn't surprise me anymore. What I'm saying is that you people haven't had that experience. We have

at the State level. We can't help you, but you can learn from the problems.

Senator HATCH. The offbudget item is a perfect illustration. When Dennis and I became Senators in 1976, offbudget items were approximately $8 billion. In fiscal year 1981 it is $23 billion. President Carter said he was going to phase this out. Every President has said it, but when they find out wht a wonderful little dodge it is, they continue the practice.

We have addressed that, however. Section 5 would require Congress to put offbudget items on budget.

I agree with your criticism of section 4. "Additional activities" is an undefined term. We need to work on section 4 to make that a better section. I think all of us on the committee agreed on that. We've asked the National Tax Limitation people to help us with this because this is a section they have great interest in.

Some have also worried about that section nullifying the 10th amendment to the Constitution; we certainly don't intend that. So, we have to come out with a little better language. You've made a very good point there.

Mr. MORRIS. Nevertheless, you are on the right track. Even if this is what we get, it's better than what we have.

Senator HATCH. Thank you. Your testimony has been very enlightening. Senator DeConcini.

Senator DECONCINI. Mr. Chairman, I'd like to just point out for the record, the Arizona Tax Research Association has been one of the moving forces in maintaining some sanity, in the State of Arizona, in the ever escalating taxes. We're like Utah, we have a very small percentage of privately owned land, and the temptation of well-intentioned officials is to increase that property tax all the time. This association of Mr. Morris is to be credited with the leadership of constantly being conscious of the people who have to pay the bill.

Senator HATCH. That's a tough position.

Mr. MORRIS. You never run out of work.

Senator DECONCINI. It's not always the most popular position, I'm sure, when you have to continuously go against many good people. In any event, thank you, Mr. Morris.

Senator HATCH. I think you should compliment us for not bringing up the Sagebrush Rebellion here.

Mr. MORRIS. I haven't brought it up yet, but I'm about ready to.

[The prepared statement and additional material submitted by Mr. Morris follow:]

PREPARED STATEMENT OF MELVIN MORRIS

Thank you for the opportunity to testify in support of federal spending limitations.

The need for binding restraints on federal spending has been recognized for some time by taxpayers. In the past 15 years I have been involved both for and against innumerable attempts to place limits on state and local spending in Arizona and California. In every one of those instances there have been large blocks of citizens who have asked, "How can we place a limit on the Federal government?" Often those same people indicated they had only limited interest in the controls proposed for local government but would vote for them in hopes the message would be transmitted to Washington. If the mechanism existed for citizens to amend the Federal Constitution by initiative, we would have had taxing and spending limits several years ago.

So that you understand briefly how Arizonans have indicated they feel on the issue of limitations, in 1978, 78% of the voters approved a measure which limited the state legislature's authority to appropriate at 7% of the total personal income of the state. Then in 1980 comprehensive limitations were imposed on local government. There were 10 measures before the voters and the key ones received 83% to 85% of the vote. Subsequently voters rejected a clone of California's Proposition 13, but that was because they felt the job had been done and that an import from California was not needed.

Those of us who have worked for and against state and local limitations have become keenly aware that much of the support for those comes from a revolt against the total of the taxes citizens pay, and in many instances the Federal taxes are the major contributor. Tax Foundation each year calculates the average citizen's taxes and then determines a Tax Freedom Day---a day when a person will start working for himself, assuming that he first meets all of his tax obligations. This year that day was May 10th, six days later than last year. In 1970 it was April 28th and in 1960 it was April 18th. That day, artificial as it is, clearly points up the problem. Taxes are taking an increasingly disproportionate part of our earnings.

The various constitutional and statute limitations proposed and enacted are at best an imperfect approach. Most Western states have some of these limitations and the rate of their change suggests there is good reason for caution in adopting a Federal limitation. The ideal limitation is attentive

citizens who monitor their government. But our governments have expanded so greatly in the past 40 years that it no longer is possible for that citizen supervision. As a substitute for our ability to attend budget hearings and monitor our government, we have adopted artificial controls. We recognize these are only substitutes and are imperfect.

States and local governments can change statutes and constitutions comparatively easily and rapidly. In the West, particularly, we have found it easy to test limitations, adjust them, even abandon them and start anew.

We are aware Federal procedures make this kind of trial and error government impossible. Therefore, it is essential that the approach you adopt be thought through carefully. In this respect, we at the state level cannot be too helpful in that we do not understand fully the intricacies of Congress. You, however, can benefit from the errors which have been made in the tax limitation laboratories of state and local government.

Even in state and local government, where we do not have the ability to deficit finance, we have learned that both revenue and spending limits are essential if a program is to work. At the Federal level, where deficit financing is not only possible it has become habitual, both controls will be needed and will be difficult to achieve.

Before talking about the traps which must be avoided in adopting these limits, let me first talk about the approaches which should work. I served as a member of the National Tax Conferences Committee which prepared a Policy Statement on Limiting Federal Spending in the fall of 1979. Copies of that statement are being included with this presentation.

Basically, in reviewing the Federal legislation, we believed that policy statements such as that included in the 1978 Revenue Act probably would have worked had they been binding rather than an unheeded statement of policy. In that Act it was proposed that Federal outlays be limited to a percentage of the Gross National Product <GNP>. It would start at 21% in 1980 and slowly decline.

The same approach was taken in Public Law 96-10, Section 6, except the decline in expenditures would start at 21% of the GNP in 1981. Congress, however, did not regard those policy statements too highly, as subsequent spending proved.

It was the conclusion of those of us in the National Tax Conference that policy statements simply will not do the job. Binding language is needed and it should be binding both on the Congress and on the President. Therefore, we suggested it should be amended into the Congressional Budget Act as a binding limitation and not as a proclamation of policy.

Had Congress included binding language sooner, we would have had an opportunity to see what the problems are. Every proposal, no matter how carefully thought out, needs fine tuning. If today we had two years of operation under this kind of statutory limitation, we would all be better qualified to say specifically what should be included in a Constitutional limitation.

The only thing we have learned is that without a Constitutional limitation, Congress is unlikely to exercise control of spending and taxation which the citizens want. The cavalier disregard of those policy statements does not make any of us want to support more of the same. Thus, instead of seeking a logical transition to limitations where we can remove the flaws, the mood has grown for immediate limitations which will be difficult to adjust or correct.

Whichever limitation is finally adopted, it should have several components.

First of all, we all recognize, it must have a limited escape clause in cases of national emergency. National emergencies, however, must be narrowly defined either by a procedure for declaration of the emergency or by preconceived limitations on what is an emergency. National defense, we would all agree, would qualify. After that the opportunities for consensus of definition fade. Therefore our suggestion is that the President should have to declare an emergency and a greater than simple majority of both houses would have to agree. It is our opinion, also, that all emergencies, including war, should have a limited life---say one year. If it is necessary to go beyond a year, it should require the President and Congress to reaffirm that an emergency still exists.

Secondly, a base has to be determined. In Arizona we chose total personal income as the base to measure and limit appropriations. The basic idea was that it is time government lived within the ability of its citizens to pay

taxes. This is the same tack taken by S. J. Resolution 58. The prior approaches at the Federal level have been to use the GNP. Before either is adopted, a thorough review should be made of the bases to see how they are determined, how subject they might be to manipulation, and how apt they would be for long range use. It might be better to give Congress the authority to determine and later change indexes to be used because this would open the door to developing an index which would be a better measure of the tax paying ability of citizens.

Experience with the Consumer Price Index prompts my warning on selection of a base. The CPI has been misused and now is one of the major instruments fueling inflation. It is being used for automatic adjustments in areas it was not designed to serve. As an example, a major part of this market basket index deals with medical costs. It is a good index of the costs, but is not an index indicating who pays those costs. Through medicaid and medicare programs and through insurance programs provided in the most part by employers, most citizens pay only a small or no part of these medical costs. When we adjust Social Security payments by the CPI, we are doubling the weights of medical costs. The same thing happens in labor contracts which are adjusted by the CPI if the employer also pays all medical costs. A similar flaw occurs because the CPI assumes a person buys a new home annually. In fact, most do not. That, too, disproportionately fuels inflation.

I suspect we will find that both the GNP and personal income base as an index may develop flaws once they become annual base indexes applied to federal appropriations or tax limits. So our recommendation is to take the best available index for now but leave room for improvement.

The mood of the nation, we believe is clearly in support of a Constitutional limitation. This process at the Federal level is not instantaneous, however, and we believe that while the states are being asked to ratify or reject the amendment, the concepts should be placed into law to bind both Congress and the President. Although we do not firmly believe a Constitutional Amendment is the only answer, we do believe we need immediate limitation. By placing the language of the proposed amendment into law, you will provide an opportunity to see if it is a practical limitation. If it is

not, there should be at least two years to adjust and resubmit it to the states. In this regard, it is our opinion that the Constitution should be a careful and thoughtful document. Our preference would have been to have laws which were observed by Congress and our support for the Constitutional Amendment comes only because Congress has not indicated a willingness to self impose and abide by limitations.

Careful consideration should be given to define what is subject to limitation. It is our belief that both the unified budget and off budget entities should be limited. Only those of you who have worked the massive Federal Budget really know how to draw definitions which will be meaningful. But it is here that errors made by state and local governments can guide you. Arizona's limitation, for example, excludes bond interest and redemption from the limitations. The language, however, was written to protect the value of all bonds and to stress that all costs would be outside the limitation. We are beginning to find that bond sales language includes language mandating maintenance of structures built with bonds. By extension, we can anticipate that we will have some government entities which may claim that their maintenance and operation of facilities, because it is part of the bond language, is outside all limitations. The intent of the limitation will be bypassed.

Let me stress here that what we think the citizens want is a limitation which will work and which will be honored. It has been our experience that creative legislators and budget experts can find ways to defeat most limitations and that is the main reason most states with limitations have had to try several before they obtained one they believe will work.

The limitations we have in place, however, are closer to the citizens and there is a chance for citizen input when the limitations are being abused. That will not be true of Federal limitations. Washington is a great distance from most of us, and we will not have the monitoring groups such as the Taxpayer Associations and Chambers of Commerce which police these acts at the state and local level.

Therefore, the most vital need is one which you cannot write into law or the Constitution. It is a need for Senators and Representatives who believe in the limit and are determined to make it work. If you give us what seems to be

a limitation to pacify the taxpayer unrest but leave loopholes which your fellow legislators can use to neuter the limitation, then you will be increasing the citizen distrust and unrest at a time when we need to improve citizen respect for government.

Limitations are not intended to make it easy on government spenders. They are intended to force some priority decisions so the available money can be used to best advantage. This means there should be some reduction from current spending levels and, as a bare minimum, it means the limitations should gradually reduce the percentage that government taxes away from our incomes.

It is here that I believe there is a major flaw in S. J. Resolution 58. It assumes that the present level of taxation is acceptable. It is not. By limiting increases in the limitation to the increase in personal income from one year to the next, you maintain the present level of taxation. That would be better than what is occurring now where the ratio is accelerating. But what we all want is more than a stop to the rate of growth, we want to see some reversal, however slight.

A second problem I see with the specific wording of the resolution relates to debt retirement. Most of us do not understand a trillion dollars in debt, but we come from the Puritan school which believes debts must be paid. Therefore, I think there should be a clue in the measure to indicate exactly how the debt service, which is outside the limit, will be handled.

Limitations need escape clauses if expenditures are mandated by another level of government, including the courts. For example, how will SJR 58 treat a court mandate such as occurred on busing? I also wonder if the term "activities" in Section 4 is too vague.

Finally, before final action, review needs to be made of the many enterprise like funds to see how they will actually be regulated. What happens to the Social Security Trust Fund? What happens to the highway funds? We are arguing for their limitations, but would prefer to be assured there really is a limitation.

Thank you. If there are any questions, I will try to answer them.

National Taxpayers Conference

Policy Statement on Limiting Federal Spending

National Taxpayers Conference

Officers

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Preface

Across the nation, taxpayers have been telling their state and local officials that there is a limit to how much they are willing to spend for government.

Ironically, much of the taxpayers revolt seems to have been inspired by federal spending, but citizens have not had the same access to federal officials. It is becoming increasingly apparent, however, that the public desire to limit spending at the federal level is just as intense as it is for the state and local levels of government.

The National Taxpayers Conference (NTC), representing taxpayers in 29 states across the nation, recognizes these public attitudes and urges responsible action by Congress immediately. The citizens want a meaningful limit placed on federal spending so that government will no longer take an increasing portion of our gross national product. The NTC believes Congress is the best vehicle for responding to the public's desires.

Congress, which has the historical experience of meeting the budgetary needs of the nation in times of crises, depression and prosperity, can best provide a limitation mechanism which will succeed. Failing that, however, it is increasingly clear that the citizens, who do not have the same experience but who are best aware that they cannot continue to give more and more to support government, will force their own limitation--even if it is imperfect.

Therefore, it is in the best interest of the nation and its citizenry for immediate, positive action to limit federal spending.

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POLICY STATEMENT ON LIMITING FEDERAL SPENDING

October 1979

I. INTRODUCTION

The taxing and borrowing powers of the federal government are virtually unlimited. As the realization of this fact has grown among special interest groups and state and local governments, they have tended to turn more and more to Washington for assistance to meet their needs and wants. There are areas where federal aid is both desirable and required, but the absence of any effective restrictions on federal taxing and borrowing powers has been a key element in the shifting federal-state-local fiscal relationships since the 1930's and has led to an increasing dominance of the federal government over the life of every American.

Rapidly increasing federal spending has not only affected the federal system, but has also added heavily to the tax burdens on America's workforce. Of equal significance, huge federal budget deficits fuel inflation, thereby diminishing the value of the dollar and imperiling individual purchasing power.

Thus the call for creating a "defense against spending pressure" and some form of ceiling or limitation on annual federal spending is not only clearly justified, it deserves priority consideration. Public concern over federal spending has, however, occasionally resulted in conflicting demands for tax cuts, spending ceilings and balanced budgets. Table 1, prepared by the Advisory Commission on Intergovernmental Relations, illustrates the broad spectrum of remedies currently being proposed to control federal spending. The National Taxpayers Conference's purpose in this policy statement is not to reconcile these proposals, but rather to set forth what it believes to be the "best practices" and the most feasible approach to a mandatory federal spending limitation.

II. FEDERAL FISCAL TRENDS

Analysis of federal fiscal trends over the past twenty years indicates that government spending has grown too rapidly and has become too intrusive.

The National Debt

The federal budget has been in balance only twice during the past two decades. In the twenty year period ending with fiscal year 1978, the federal debt increased by $500.7 billion, or 179%, to $780.4 billion. Based on current estimates, the accumulated national debt is projected to approach the one trillion dollar mark by fiscal year 1982.

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Table 1

A Classifiation of Various Proposals for Introducing Greater Fiscal Restraint at the Federal Level

Type of Restraint (Fiscal Policies)	Ad Hoc Adjustments (Current Policy)	Indirect Statutory Controls (Strengthened Political Accountability)	Direct Statutory Controls	Direct Constitutional Controls Subject to Extraordinary Majority Rule
Income Tax Controls	IA Ad hoc moderate tax reductions.	IB Indexation to prevent unlegislated tax rate increase due to inflation.[1]	IC Statutory income tax limits tied to specified percentages of a national income measure (Kemp-Roth and Jarvis tax proposals).	ID Income tax collections tied to specified percentages of a national income measure, unless restrictions lifted with extraordinary majority approval in both houses.
Expenditure Controls	IIA Slowdown in expenditure growth--no major new initiatives, most existing programs funded at current service levels. Some program reductions.	IIB "Sunset" legislation that requires Congress to evaluate systematically the effectiveness of existing programs.[1]	IIC Statutory spending limits tied to specified percentages of a national income measure (Kemp-Roth expenditure proposal).	IID Expenditures tied to specified percentages of a national income measure, unless restriction lifted with extraordinary majority approval in both houses (National Tax Limitation Committee proposal).
Balanced Budget Controls	IIIA A gradual reduction in budget deficits.	IIIB If President and Budget Committees submit unbalanced budgets, they must also submit balanced budget alternatives (Long Amendment).[2]	IIIC Statutory mandate for balanced budget (Dole proposal).	IIID Deficits prohibited unless approved by extraordinary majority vote in both houses (most common of the Constitutional proposals).[3]

NOTE: Moving from left to right, the restraints become more restrictive or more difficult to alter or both.

[1]ACIR recommendation.
[2]Public Law 96-5--beginning with fiscal year 1981, Congress must consider a balanced budget resolution.
[3]Certain proposals for amending the Constitution are even more restrictive--S.J. Res. 18 also contains a provision for repayment of the national debt; S.J. Res. 16 requires that revenues after the third year exceed expenditures by at least 5% for the next 20 years.

SOURCE: Advisory Commission on Intergovernmental Relations, Intergovernmental Perspective, Spring, 1979, Vol. 5, No. 2

Since spending programs are more popular with the electorate than higher taxes, the continuing predilection of the United States government to finance its programs by deficit spending will only be altered by the enactment of procedures that offset existing political pressures to spend and borrow.

Expenditure Trends

Over the past twenty years, federal spending, as measured by the unified budget, has increased almost six-fold--growing from $92.2 billion in 1960 to an estimated $542.4 billion in 1980. As shown in Table 2, actual federal spending has been growing at a faster pace in the 1970's than it did in the previous decade. Of even greater significance, federal spending has been growing at a pace in excess of the rate of inflation. As measured in constant dollars (fiscal 1972 prices), federal government spending increased from $151.0 billion in 1960 to $291.3 billion in 1980, an increase of almost 93%.

Table 2

Federal Spending, 1960-1980
(in billions)

			1960-1970 Increase				1970-1980 Increase	
Unified Budget	1960	1970	Amount	%	1970	1980	Amount	%
Actual	$ 92.2	$196.6	$104.4	113%	$196.6	$542.4[b]	$345.8	176%
Adj. for Infl.[a]	151.0	221.0	70.0	46%	221.0	291.3[c]	70.3	32%

[a]1972 prices.

[b]Total projected in July 1979 revision of fiscal 1980 outlay estimate.

[c]Estimated, based on data provided in original January 1979 budget projections.

In historical perspective, federal government spending did not exceed $100 billion until 1962, the 186th year after the Declaration of Independence. Yet, by our 200th national birthday, the federal budget exceeded $366 billion, and is projected to reach $642 billion in fiscal year 1982.

Expenditure Patterns

While national defense spending has accounted for a decreasing percentage of total federal expenditures, major increases have occurred in social programs, i.e., programs focusing on health, income security, education, training and employment, and various human services. The percentage of total federal expenditures for defense has declined from 49.8% of federal outlays in 1960 to 23.7% in the 1980 budget. Conversely, spending for social programs comprised 21.8% of total federal spending in 1960, but now, in the 1980 budget, accounts for almost 50% of the total.

What has been the consequence of the growth and direction

of government spending? In 1978, all federal, state and local government expenditures accounted for 36% of the dollar value of our nation's entire production of goods and services, in contrast to 30% in 1960 and 20% in 1940. The growth of government at the expense of the private sector reflects to a large degree the expansion of federal spending on social programs. While this increase in federal spending has resulted in burdensome taxes and huge federal deficits, it is difficult to measure the impact federal spending has had on social ills such as youth and minority unemployment, urban decay, crime, quality of education, and welfare dependence that it was intended to help cure.

III. FEDERAL SPENDING LIMITATION APPROACHES

A proposal to limit federal spending should not be viewed as a negative reaction by the taxpaying public. Rather, it could be a valuable tool in making the difficult programmatic choices and priority decisions which must be confronted if federal spending growth is to be restrained.

Although a limitation provision can take many forms, there are essentially five major avenues of approach. These include:

- Reliance upon existing budgetary processes and commitments from officials to restrain spending, or provide an "orderly transition" to budget balances;
- A tax limitation to restrict the availability of revenues;
- A constitutional amendment mandating budget balance, except in emergencies;
- A constitutional amendment providing for a limitation on total federal government spending, or upon the year-to-year growth of total spending; and
- A statutory limitation upon total spending or annual spending increases.

Arguments for and against each of these approaches can be made. In the interest of time and space, only the major points are summarized in this discussion.

Existing Processes

Reliance upon existing budgetary processes would require a "reform of the will" on the part of Congress and the Executive Branch which recent history suggests is unlikely to occur, or at least to be sustained over a period of time. While the President's 1980 budget does provide for some spending restraints, it also proposes new spending authority levels which are likely to contribute to pressures for increased spending in future years.

The new congressional budget process adopted in 1974 has proven to be a useful tool in some respects, but the Congress has yet to demonstrate a capacity to use it effectively. In the four fiscal years for which Congress has operated under the provisions of the Congressional Budget and Impoundment Control Act of 1974, federal outlays increased from $326.2 billion in 1975 to an estimated $496.2 billion in 1979--an increase of $170.0 billion or 52%. For the preceding four-year period, outlays rose from $196.6 billion in 1970 to $269.6 billion in 1974, an increase of $73.0 billion or 37%. Furthermore, deficit spending has accelerated since passage of the Congressional Budget Act of 1974. Between 1970 and 1974 federal debt grew by $103.6 billion, compared to growth of $295.1 billion for the period 1975 through 1979.

Finally, the "binding" ceilings on spending and the deficit in the second budget resolution have not really been totally effective and have been modified quite often. The congressional spending "limit" in that resolution has usually been above the actual spending totals.

In summary, while the Congressional Budget Act of 1974 has engendered a more coordinated consideration of budgetary matters by the Congress, analysis indicates that it has not curbed the growth in federal spending or the inclination of the federal government to deficit finance. Claims that the size of the deficits have been reduced overlook the fact that much of the reduction has been due to the so-called "spending shortfall." These facts indicate that reliance on the existing budget process or other proposals--such as sunset legislation or zero-based budgeting--will not, by themselves, change the federal government's fiscal practices.

Tax Limitation

A *tax limitation* designed to restrict the amount of revenue available for expenditure is not a feasible means to limit federal spending, in view of the ability of the federal government to use deficit financing to fund expenditure programs. Given the lack of an effective control upon incurrence of new debt at the federal level--and budget deficits in recent years--the argument that "if they don't have the money, they can't spend it" is not substantiated by events.

Balanced Budget Amendment

A *constitutional amendment to require an annual budget balance* except in periods of emergency has great attraction as an objective but presents several difficulties. Whether or not the federal budget is balanced depends upon three factors: expenditures, tax rates, and taxable income. The Executive and Legislative Branches control expenditures and tax rates, but not taxable income. Therefore, when income declines, a budget that was projected to be balanced may not be. Under this condition, balancing

the budget would necessitate that either tax rates be hiked or federal spending reduced.

Charles L. Schultze, Chairman of the Council of Economic Advisors, examined the impact a balanced budget amendment could have had during a period of recession. In testimony to the House Committee on the Judiciary, he stated:

> In fiscal 1974, the year in which the recession began, the Federal budget was almost in balance--the deficit was only $4½ billion. By fiscal 1976, the deficit had risen to $66 billion, in large part because of the loss of revenues that occurred automatically because of the recession. A small part of the deficit occurred because tax rates were cut and expenditures raised to stop the recession and turn the economy around....
>
> We have used three independent econometric models to estimate the expenditure cuts or tax increases which would have been required to balance the budget in 1975 and 1976, and to estimate what the economic consequences would have been....
>
> Although there were some differences in results, all three models showed that huge expenditure cuts would have been required and that unemployment would have skyrocketed. In addition to cancelling the $15 billion tax cut enacted in 1975, and the $8 billion rebate of payments on 1974 taxes, expenditures would have had to be reduced by roughly $50 billion in fiscal 1975 and by $100 billion in fiscal 1976. Real gross national product in 1975 would have been about 12% below the 1973 level (compared to an actual fall of 2½%). The unemployment rate would have risen to 12% in 1975 (the actual level was 8.5%).

A balanced budget amendment would also be difficult to administer in the absence of specific language defining what constitutes the federal budget and which accounting format is to be used. Since any definition would not be free of alternative interpretations, the federal judiciary could become more involved in rendering fiscal decisions. In the absence of such definitions, "creative accounting" by the federal government could easily avoid the intent of the balanced budget amendment.

Spending Limitation Amendment

A *constitutional amendment providing for a spending limitation* is preferable to an amendment requiring a balanced federal budget because it would place a ceiling or limit on the amount of dollars the federal government could appropriate in any particular year. However, adoption of any constitutional amendment encounters significant difficulties.

First is the length of time that would pass before any such provision could become effective, even if ratification were ulti-

mately achieved. Second and more serious is the probability that any such provision would be subjected to legal challenge. This not only is time-consuming and creates uncertainties, but also raises the danger of further judicial intervention into policy areas heretofore reserved to the Congress and Executive Branch.

Statutory Limitation

With respect to a *statutory limitation*, its major weakness is its susceptibility to amendment or repeal. However, in view of the uncertainties of administrative and judicial interpretation, impact on the economy, reaction to emergencies, as well as the time required to obtain ratification of a constitutional amendment, a statutory spending limitation appears preferable. It also offers an opportunity to test the workability of specific provisions prior to adoption of a constitutional amendment.

To achieve the desired results and to overcome the weaknesses of existing spending control statutes, the following sections summarize potential provisions of a federal expenditure limitation statute which would test the "will" of the President and Congress to enforce a statutory limitation.

IV. COMPONENTS OF A SPENDING LIMITATION PROPOSAL

A spending limit is aimed at the appropriations process; to be effective, it should have the following characteristics:

The Limitation Formula

A limitation formula can be based on any one of a number of economic factors--gross national product, personal income, etc. As a matter of national policy, there appears to have developed a consensus that federal outlays should be related to a percentage of the gross national product (GNP).

In his fiscal year 1980 budget message, President Carter stated:

> Budget outlays will decrease as a share of the Nation's gross national product from 22.1% in 1978 to 21.2% in 1980 and 20.3% in 1982. This reduction in the share of our national product spent by the Federal Government is a fundamental goal of my policy, equally as important as reducing the deficit.

The Revenue Act of 1978 which became law last November (Public Law 95-600) includes Section 3 which pertains to policy with respect to additional tax reductions. This provision is as follows:

> ....Federal outlays as a percentage of gross national product

should decline to below 21 percent in fiscal year 1980, 20.5 percent in fiscal year 1981, 20 percent in fiscal year 1982, and 19.5 percent in fiscal year 1983; and the Federal budget should be balanced in fiscal years 1982 and 1983. If these conditions are met, it is the intention that the tax-writing committees of Congress will report legislation providing significant tax reductions for individuals to the extent that these tax reductions are justified in the light of prevailing and expected economic conditions.

Section 6 of Public Law 96-10 (May 1979) dealing with the authority of the Council on Wage and Price Stability contains still another provision directed ostensibly toward limiting federal outlays to a percent of GNP. This provision amends the Employment Act of 1946 to include as one of its goals:

....(3) reducing the share of the Nation's gross national product accounted for by Federal outlays to 21 per centum or less by 1981, and to 20 per centum or less by 1983 and thereafter, or the lowest level consistent with national needs and priorities....

In view of the past congressional actions and President Carter's goal, there is no benefit in attempting to set forth any alternative limitation formulas. Indeed, limiting federal outlays to a percentage of the gross national product is a sound approach for the following reasons:

- The vitality of our economic system and the stability of our social and political institutions depend fundamentally on the strength of the private sector. Indexing federal spending to a fixed percent of the gross national product would prevent additional inroads of government on the private sector.

- As the dollar value of our nation's entire production of goods and services increased, the federal government would be able to share in this economic growth. This provides an added incentive to protect and promote a healthy economy.

- Federal spending ceilings resulting from implementation of this formula can be achieved by moderating budgetary growth without massive reductions in federal programs.

- The formula does not automatically accept or reject existing spending levels as being appropriate or inappropriate.

The Spending Base

The spending base to which the limitation is applied should

be defined with the goal of eliminating exemptions to the limit. A federal unified budget concept currently in use, first adopted in 1969, is designed to provide a comprehensive federal budget, with exclusions held to a minimum. In recent years, however, there have been some departures from this concept of comprehensive coverage.

Notable among these departures has been the exclusion from the budget totals, by law, of the transactions of certain agencies and entities--the so-called "off-budget entities." This practice began in 1971, and the dollar size of these exclusions has become significant.

In addition, certain types of funds or transactions, involving substantial amounts, are reflected in budget totals only on a "net" basis, i.e., those totals include only the excess of disbursements over receipts, or vice versa; and significant payments to the government are treated in the unified budget not as receipts but as off-sets against outlays, or negative expenditures. However, to avoid confusion and complexities in drafting a limitation, the federal spending base should be defined to include the *"unified budget total plus off-budget entity transactions."*

The spending limitation should make no distinction between so-called "controllable" and "uncontrollable" expenditures. There are differences in the definitions of controllability between Congress and the Executive Branch. Basically, however, the term "uncontrollable" is a misnomer which too often becomes a "cop-out." The term "relatively uncontrollable" really means uncontrollable in any given year under existing law. The key phrase here is "under existing law." There are few federal programs or outlays which cannot be controlled or changed by changes in existing statutues. Eligibility requirements, distribution formulas, benefit levels, etc., can be changed to affect the outlays of almost any program.

Emergency Provisions

Provisions should be made for emergencies. Unforeseen circumstances with major negative effects do arise. In these unusual situations, the public's desire for spending control may for a time be outweighed by a consensus that there is an obligation to relieve hardship, assist victims, or restore the condition of public works and facilities.

Such a provision should require a declaration of emergency by the President and ratification by a two-thirds vote of each House of Congress. However, any declaration of emergency, to permit exceeding the spending limit, should be for one fiscal year only.

Anti-Shift Language

Provision should be made to protect state and local govern-

ments from bearing the cost of new programs or program enlargements mandated by the federal government. The purpose of this provision is to prevent the federal government from shifting responsibility for funding programs and services to state and local governments as a means of circumventing a federal spending limitation requirement.

Recognizing that in a federal system the national government may be required to mandate programs on the states and localities in order to protect the basic constitutional rights of the people and promote the general welfare, certain procedures should be considered to protect the state and local governments from unreasonable federally imposed programs which result in increased state and local spending. These procedures should include:

- Preparation, by the Congressional Budget Office, of a fiscal impact statement for all legislation that would have a fiscal impact on state and local governments.

- A provision in the federal law that would either (1) require the federal government to reimburse state and local governments for the full cost of implementing congressional and executive directives, including new programs, increased service requirements, and maintenance-of-effort requirements that lead to increased state and local expenditures and revenue losses, or (2) include a "disclosure" in any federal legislation or directive why reimbursement is not provided.

V. A PLAN TO CONTROL FEDERAL SPENDING

To effectively control the growth in federal government spending, the National Taxpayers Conference supports a program that includes:

- Enactment of measures to limit the growth in federal government spending; and

- Enactment of procedures that assure greater accountability for federal tax and spending decisions.

The purpose of this section is to outline a specific proposal to limit federal spending.

Enactment of a Spending Limitation Statute

Before a constitutional spending limitation is proposed and ratified, the feasibility of a federal spending limitation should be tested through a statute. There are at present four specific provisions in existing statutes directed toward the expenditure limitation or balanced budget objectives. However, the provisions dealing with expenditure limitation are, in effect, merely "sense

of the Congress" statements and have little or no force or effect.

Amend the Congressional Budget Act

A logical place to insert a statutory provision limiting federal outlays each year would be the Congressional Budget Act of 1974 (Titles I through IX of Public Law 93-344). Section 2 of that Act sets forth a "declaration of purposes" which includes the following:

(1) To assure effective congressional control over the budgetary process;

(2) To provide for the congressional determination each year of the appropriate level of federal revenues and expenditures;

(3) To provide a system of impoundment control;

(4) To establish national budget priorities; and

(5) To provide for the furnishing of information by the Executive Branch in a manner that will assist the Congress in discharging its duties.

Since the obvious purpose of any limitation is directed toward establishing an "appropriate" level of annual federal outlays, and requiring the Congress to reach decisions as to budgetary priorities within such limitation, it would appear to be consistent with this declaration of purposes in the 1974 Act.

Titles I through V of the 1974 Act deal with establishment of the Budget Committees and the Congressional Budget Office, the timetable and rules governing the new congressional budget process, provisions to improve fiscal procedures, and changes in the fiscal year. Many of the provisions in these titles of the Act involve the rules of the House and Senate. Each House operates under different rules in many respects, and each determines its own rules. These rules (and also the concurrent resolutions in which Congress sets its budget totals) do not, of course, require concurrence or signature by the President. The rules of either body are subject to change at any time by action of the membership.

Title VI of the 1974 Act, however, deals with amendments to the Budget and Accounting Act of 1921. It contains provisions relating to matters to be included in the President's budget, requirement for a mid-year budget review, 5-year budget projections, and current services budget, etc.

It should be emphasized that the "binding" totals in the final concurrent budget resolution adopted each year by Congress are binding only upon the Congress--not the Executive Branch. A statutory limitation provision, if it is to be fully effective,

therefore, should be made applicable to both the President's annual budget submission and the outlay total in the final congressional budget resolution. For this reason it would appear most logical to propose such a limitation provision as an amendment to the Budget and Accounting Act of 1921 by adding it as a provision in Title VI of the Congressional Budget Act of 1974.

A Percentage of GNP

Limiting federal spending to a ratio or percentage of the gross national product is a sound means to assure that the federal government does not continue to increase spending at the expense of the private sector for the reasons set forth in Chapter IV.

In light of the section in the Revenue Act of 1978 which states that federal outlays as a percentage of GNP should decline from 21% in fiscal year 1980 to 19.5% in fiscal year 1983, it is suggested that the Congressional Budget Act of 1974 be amended in a way which, in effect, sets out the already existing formula as a mandatory spending limitation.

If the federal spending ceiling was set as a percentage of the projected budget year GNP, as in the Revenue Act of 1978, federal spending would be limited to 21% of GNP in 1980, 20.5% in 1981, 20.0% in 1982, and 19.5% in 1983. Using this approach, the total outlays proposed by the President in his budget submission and those approved by Congress in the September budget resolution for the ensuing fiscal year could not exceed the stated percentage of the GNP. This action would place a firm requirement upon both the Legislative and Executive Branches to implement previously articulated national policy and goals.

As discussed earlier, the proposed spending limitation should apply to both the unified budget and off-budget entities. However, in the event of a national emergency, provision should be made to waive the ceiling for one year only by a two-thirds vote in each House after a Presidential declaration of emergency was issued.

Fiscal and Program Impact

Implementation of this spending limitation proposal in fiscal year 1980 would cause federal spending, including off-budget entities, to be no more than $540.1 billion, or $18.4 billion less than estimated federal spending of $558.5 billion that is projected for fiscal year 1980. The ceiling would result in only a 3.3% reduction in projected federal spending for fiscal 1980--a level of reduction that should be achieved by more efficient management not by widespread elimination or cut-backs in existing federal programs.

A summary of the fiscal impact of limiting federal spending to a percentage of the GNP which declines from 21.0% of GNP to 19.5% over a four year period is set-forth in Table 3.

Table 3

Federal Spending as a Percentage of GNP
(in billions)

Fiscal Year	GNP*	% GNP Ceiling	Spending Limitation	Est. Total* Federal Outlays Amount	Est. Total* Federal Outlays % GNP	Difference Est. Outlays vs. Spending Limitation Amount	Difference Est. Outlays vs. Spending Limitation % of GNP
1980	$2,572	21.0%	$540.1	$558.5[a]	21.7%	$(18.4)	0.7%
1981	2,859	20.5	586.1	610.8[b]	21.4	(24.7)	0.9
1982	3,169	20.0	633.8	653.4[b]	20.6	(19.6)	0.6
1983	3,448	19.5	672.4	712.0[c]	20.6	(39.6)	1.2

[a]Includes $16.1 billion in outlays of off-budget federal entities, revised by July 1979 *Mid-Session Review of the 1980 Budget.*

[b]Includes $11.5 billion for fiscal 1981 and $11.1 billion for fiscal 1982 in outlays of off-budget entities from *Budget of the United States Government, Fiscal Year 1980* (January 1979), which are latest estimates available.

[c]Assumes $11.1 billion in estimated outlays of off-budget entities, same as in 1982.

*Source: *Mid-Session Review of the 1980 Budget*, Office of Management and Budget, July 12, 1979.

This proposal, based on current revenue and outlay projections, would produce surpluses of approximately $11 billion in 1981 and $55 billion in 1982. These surpluses would be available for either debt retirement or tax reductions, but not for additional federal spending.

In Conclusion

Too often in the past, both the Congress and the President have advocated spending restraint but have not practiced it. If the growth in federal spending is to be controlled, therefore, a formal legal restraint is needed.

The National Taxpayers Conference believes that the limitation proposal suggested in this policy statement would help to stabilize the government's share of the national production of goods and services, would encourage the Executive and Congress to confront the difficult programmatic and budgetary decisions necessary for sound fiscal policy, and would enhance the prospects for budget balance.

Senator HATCH. Our next witness will be Mr. James E. Weaver from the Sun City Homeowners Association. We're glad you're here, Mr. Weaver.

STATEMENT OF JAMES E. WEAVER, SUN CITY HOMEOWNERS ASSOCIATION

Senator HATCH. You know, there have been several thousand proposed amendments to the Constitution. Of these, only 33 have emerged from the proposal process, and only 26 have become part ot the Constitution.

Of the other seven, only two are still alive: The equal rights amendment, and the D.C. voter representation amendment. It's apparent that the Founding Fathers did not expect the Constitution to be an easily amendable document.

So, it's very important that we have criticism such as yours before we actually do pass on it.

We're happy to have you with us, and we are interested in your testimony.

Mr. WEAVER. I believe a large majority of the residents of Sun City are heartily in accord with the idea of a balanced budget, if in accomplishing that goal taxes are reduced, not raised, funds are not borrowed and money not printed.

Except for sections 3 and 4, it's my opinion that the proposed Senate Joint Resolution 58 is nothing more than a sequel to what has been the practice of Congress for the past 50 years. It does nothing more than continue the course of action followed by each successive Congress, which has resulted in constant increase in total transfer payments, larger and larger deficits and higher and higher interest and inflation rates.

The people are very tired of these actions by Congress. Can we not hope that Congress will bite the bullet and dispense with past spending practices and enact a new script?

Sections 1 and 2 of the proposed resolution are quite confusing. They contain exceptions to exceptions to exceptions. They provide adoption of an amount of receipts and outlays. They amend such amounts but keep them in balance, resulting in tax increase.

Prior to or during the fiscal year there may be provided an excess of outlays over receipts, budget deficits and more inflation, adjustment of revenue lost so as to limit receipts to totals set forth in the statement; a tax increase.

Total receipts must be limited to that rate of increase which was no greater than the increase in national income over the last calendar year. Is it a crime to limit outlays and reduce debt?

Congress may approve specific additional receipts—a tax increase. It appears to me that this resolution is merely a smokescreen to make people believe Congress is wholeheartedly trying for a balanced budget. If they are then I suggest sections 2 and 5 be deleted entirely and all of section 1 be deleted except for the first sentence.

It is my opinion this resolution has so many exceptions to what starts out as an effort toward balanced budgets, that in actual operation it would not correct the unbalanced budget problems that have strangled this Nation for so many years.

Supplemental appropriation should be discontinued. Increasingly larger transfer payments don't let poor people out of poverty. It does, however, assure their votes are constantly cast for reelection of their benefactors.

With reference to most of our Sun City residents, they have for many years received a double whammy from Congress. They have seen larger and larger portions of their income taken away to provide transfer payments. Then what they have left, plus their savings has been greatly reduced in value by increasingly inflationary measures of the past 20 years.

We have tried to provide for our later years. Congress seems to be doing everything possible to place us in the same position they have for years placed recipients of transfer payments. This latter group includes, in case you don't realize it, all of those people operating under price supports.

Balancing the budget without gimmickry would correct these problems. Thank you for allowing me your time to tell you what I think about budget balancing and the proposed resolution, which appears to me to be constitutional authorization of the same methods used by past Congresses to create large deficits, high inflation, and tremendous national debt and destroy the middle class of the population.

Senator HATCH. Thank you so much, Mr. Weaver. We are happy to have your testimony. If I have interpreted it correctly, you feel as if this amendment, although it may be an improvement upon the present system, it doesn't go far enough.

Mr. WEAVER. It doesn't go far enough.

Senator HATCH. I think you have to admit that, under the present system, we do not have any real balancing the budget requirement.

Mr. WEAVER. I realize that's what is wrong.

Senator HATCH. In fiscal year 1980 we didn't even enact a second budget resolution, which by law has to be done by September 15. Being that it was an election year, nobody wanted to admit the $80 billion deficit in the so-called balanced budget.

I've enjoyed listening to you. I've enjoyed your comments. I think one thing that you may have failed to observe is that unbalancing the budget would require a three-fifths vote, which is a very difficult thing to obtain in both the House and Senate.

It is difficult because people become very irritated at efforts, clearly understood, to unbalance the budget. That's one reason we have that particular provision.

On the other hand, if we didn't have a safety valve provision, if we were required to automatically balance the budget, we would seriously suffer during those times when a deficit might be justified.

I agree that we should have as tough an amendment as possible, and you need to recognize that this amendment is much tougher than the present system. I hope that you will spend more time reviewing it; and please take into consideration how difficult it is to reach a consensus in the Congress.

Mr. WEAVER. I think you will agree with me, if the future Congress is composed of the type of individuals that have been in the Congress for the past 50 years, that they would interpret this exactly the same as I do.

Senator HATCH. I don't think so.

Mr. WEAVER. I do.

Senator HATCH. As a matter of fact, those who we would generally call the "budget busters" in the Congress would vote to bust the budget no matter what. Frankly, this amendment would make it easier for them to say no, however.

Mr. WEAVER. I will say the Congress is getting better quality individuals.

Senator HATCH. We hope we can continue to do that. This amendment may very well help us.

Senator DECONCINI. Mr. Weaver, let me relate a little experience I went through, because I agree with you. I would like to see a tougher amendment. When I was elected, I introduced what was known as the old Curtis amendment, that whatever amounts that were unbalanced were an automatic tax increase, by law, by Constitution. There was no getting around it.

So, if we in Congress today didn't have the courage to reduce it and come up with a balanced budget, we had to go home and face a pretty hostile group, raising taxes by $60 or $70 billion.

I think Senator Hatch had a very equally, strong approach when he got started in it. I think I share your anxiety, and that of the people that you represent, so many of them on fixed income or planned income, and indeed planning for the balance of their years on this Earth and in this great Nation.

So, I have struggled with whether or not this is the best we can do. I have to admit to you that although I would like to see it tougher and tighter, Senator Hatch and the staff have gone the distance. Senator HATCH has had to work with every facet in order to get a bill that would not be so watered down that there would be an automatic way of spending those deficit dollars. Though I share some of the anxiety expressed in your statement, I think this is the best we're going to do.

However, you point out some areas that we ought to get good debate on and commitments on, because one of the things that I fear, and Mr. Morris brought this up, is that Congress, in its ingenuity, may find some way to skirt this, without merely voting the three-fifths.

I think that would be difficult to do, except in time of war or real economic chaos in this country. I am concerned. I think we need to scrutinize it. I hope you would at least understand the effort that the chairman has put in. Someone who came in as strong as I did, with a very tough amendment, we couldn't get the vote. We couldn't even get it out of the subcommittee. Even modifying it to some extent, we lost it by one vote at the full committee.

I have come to the conclusion that we are better off to get a constitutional amendment so we can put everyone's feet into the fire on whatever issue that there may be for deficit dollars. So you will know in Sun City, and the people in Arizona will know, how their representative voted. Whether or not he really did vote for a balanced budget or not, this at least would provide the public with knowledge, even if Congress found a way to get around it.

Mr. WEAVER. You know, Senator, there is an old economic rule that says if something can happen, it will. If you place that on top of your present resolution, if it can be interpreted that way, it will

be. This is what I'm concerned about: the way the thing's interpreted by some of the people in Congress. Frankly, there's been enough of them over the past 50 years.

Senator DECONCINI. Well, do you think this would at least help the public to make a better judgment on those people's interpretation?

Mr. WEAVER. I think it's a good start. It needs some more work gone over beyond what you're going to get.

Senator DECONCINI. I thank you very much for your diligence here in the Sun City Homeowners Association. I've spoken to your group. I am aware of just how astute they are. Your testimony is helpful to us. I am not going to dismiss it as we try to find a better way.

Senator HATCH. We are happy to have you here, Mr. Weaver. Our next witness will be a good friend, Mr. Alvin Rabushka. I have extremely high regard for him. He has played a major role in this whole effort. We're very honored to have you here with us today, as a noted author, noted economist and, of course, professor from the Hoover Institution in Stanford, Calif.

If Dr. Stubblebine, another individual who has made an invaluable contribution to this effort, would care to join you, we would be happy to have him come to the witness chair as well.

Senator DECONCINI. Mr. Chairman, I'd just like to add that he made a very good film.

Senator HATCH. I've seen your film.

Mr. STUBBLEBINE. Thank you.

Senator HATCH. It's one of the more impressive efforts in explaining the free enterprise system. I was indeed impressed. And meant to write you.

Mr. RABUSHKA. Thank you. Bob conveyed your thoughts to me.

STATEMENT OF ALVIN RABUSHKA, ECONOMIST, HOOVER INSTITUTION

Mr. RABUSHKA. I have a formal statement I've prepared, so I won't read it; I'll talk around it. I did take the liberty to attach a Wall Street Journal piece which advocates a complete overhaul of our tax system. It's basically modeled on the tax system in that film, in Hong Kong. I'd like to talk to you, in fact, about it later sometime today, if it's possible.

Senator HATCH. I'd really be happy to talk to you about it. We respect and appreciate all the efforts you have made in this area.

Mr. RABUSHKA. As you know, I've been interested in this subject for a number of years. I've appeared before some of you before. I missed the opportunity to appear before the full committee, being overseas on a number of occasions.

I got into this business of budgeting largely through the study of Hong Kong and have written some books on its budgetary process. And I discovered they don't have deficits and they don't have public debt; rather they have surpluses and accumulated reserves, and they have high rates of economic growth.

I think there is a moral to that particular story.

I've also been very interested in the whole tax revolt and the whole tax limitation movement, specially with Proposition 13 and various

limitations that have been in existence for several years. And I'm really delighted now to have a chance to put some thoughts and comments into the record.

HISTORY OF BUDGET PROCESS

As I look back over the whole notion of budgeting in the United States, it seems to me that we had a very workable system until recently in the 20th century, where we first took revenue calculations into account and then decide what would be the allowable limit of expenditures.

In the 20th century we decided to use the tax system for other purposes. We decided to use it to redistribute income. We decided to use it as a tool of economic policy. The upshot is that we came to take spending considerations first, worried about revenues second. The result was massive deficits which have accumulated.

I've gone through the statistics on them. It's only 20 to 25 years ago that the accumulated deficits were rather modest, for example, between 1955 and 1965 they only came to $31 billion. Now, that's about half of what this current fiscal year's deficit is going to be.

Even if we multiply that into current dollars, it's not much more. Then we ran $150 billion in deficits the next decade, and in the last 4 years almost $275 billion. Incidently, the last 4 years are interesting because they are all under normal peacetime circumstances.

The national debt is going to pass the magic $1 trillion mark next year. I've calculated that's about $4,400 for every man, woman, and child in America, or for a family of four, about $17,600. Interest on this debt is going to be about 100 billion next year, give or take $10 billion, and that's about $440 per capita.

It's a lot of money to pay for past sins, and, in fact, interest will work out to about 10 cents on every Federal dollar.

There is a raging debate, of course, on the relationship between deficits and inflation. The general consensus is, to the extent they're monetized they have an inflationary effect. We have had a substantial part of these deficits monetized over the past 20 or 30 years. Thus a balanced budget will significantly ease inflationary pressures.

GROWTH OF GOVERNMENT

A second aspect is the growth of government. It's been a steady and recurring phenomenon all through the 20th century. We have seen total spending rise from 8 percent of GNP all the way up to 34 percent, of which Federal spending alone multiplied eightfold. The rise in Federal taxation, curiously, is fueled by a constitutional amendment, the income tax amendment, the 16th amendment.

So, in the 20th century, our normal, democratic budgetary practices have resulted in steadily increasing taxes and steadily increasing spending, but not increasing taxes sufficiently to keep pace with spending. We've had in the last few years an erosion in our economy with the result that people are generally much more disenchanted with our budgetary practices.

I'd like to speak specifically to two of the ideas contained in the amendment. The first is the concept of balancing the budget; the second is the concept of limiting taxation. I think the balanced

budget provision is very important, as I've argued before you gentlemen in the past.

A BALANCED BUDGET

I would like to couch my arguments in terms of normative, economic, and political terms. The very idea of a balanced budget simply asserts that society must live within its collective means. This is very similar to what I, Craig, and each of you in your own personal lives have to face. We've got to live within our means. We can borrow only when we can afford to pay it back. We don't, however, as individuals, have the right to print unlimited sums of money. So, the concept of a balanced budget brings government finances in to ordinary people's constraints. I think also, and very, very important, it solidifies the links between spending and revenue. It would force us to go back to a system which was very effective for several hundred years, of first determining what resources were available and then, secondly, against that constraint choose among the many competing claims on public spending.

The 1974 Congressional Budget Act has not curbed the Government's propensity for deficit spending or for increasing taxes. As I indicated earlier, to the extent that it eases pressures on the Federal Reserve Board to monetize debt then, it will have an effect upon reducing the pressures of inflation.

What is especially attractive about the balanced budget provision is that it does not dictate either a higher or lower or present level of Government spending and taxing. It simply eliminates the bias in our present system, which has worked in the direction of deficit spending and concurrently higher deficit spending.

Senator HATCH. Alvin, you can't believe what that's done for us as far as getting a consensus on this amendment. The fact that some of us may have preferred a tougher amendment had to be put aside if we were to achieve a consensus. Now, we have 46 cosponsors on the bill and, I think we have a number of others who will be coming on shortly.

Probably, the biggest thing that has brought them on board is that this proposal minimizes tinkering with the economy. I might also add, Craig, that we really appreciate your response to the Washington Post editorial because it's apparent they don't understand the amendment.

With defenders like you and Craig out there, we're going to have a much better chance of getting this thing through. I didn't mean to interrupt you.

Mr. RABUSHKA. That's fine. As you know, Craig and I have, in fact, disputed this point in the past, in your presence. I think for that reason that this particular resolution represents a significant improvement over prior drafts.

Senator HATCH. We give you and Craig credit in working with us and helping refine it. We have no pride of authorship, but we think it can be refined further, particularly section 4. I believe that we can come up with language that will be more acceptable.

Mr. RABUSHKA. As I've indicated to you in the past, also the latest public polls I've seen, show almost a 6-to-1 support for the idea of a balanced budget. And this has been growing steadily over the years.

I also want to, though, on section 2, I want to speak to the concept underlying section 2; that is, the idea of a limit on Federal taxes.

A TAX LIMIT

The problem we have in our country is a tax system which needs serious overhaul, I don't know how feasible the prospects are of getting it overhauled immediately. But it has, much like our budgetary system, a bias toward overspending and deficits. The system has a bias of steadily transferring automatically, to the Government from private individuals a greater share of national income.

It works through a progressive system. Of course, it works through higher and higher marginal tax rates, where people are pushed into higher and higher tax brackets. I want to make very clear, it works whether it's been pushed up due to inflation, what we might call bracket creep, or it's due to income growth.

Under our circumstances, the Government collects a disproportionately higher share of increases in national income. The sad part is that it represents taxation without voting; that is, it allows the Congress to collect an ever-increasing sum, both in absolute terms and as a share of national income, without ever having to vote an explicit increase in taxes.

Senator HATCH. Is it correct that every time the budget goes up 1 percent, the Federal Government revenue goes up 1.65 percent?

Mr. RABUSHKA. About that, that's right.

Senator HATCH. So, you're saying the Government has an interest, a vested interest in inflation. At least those of us who believe in continued governmental growth have a vested interest in continued inflation because they get more revenues as inflation goes up?

Mr. RABUSHKA. This is true. But even if we didn't have inflation at all, if we had absolutely stable prices and real economic growth, Government would still disproportionately benefit. We have, in a progressive tax system, an automatic bias of transferring more and more of the nation's output from private individuals and firms to the Government. This process has accelerated under inflation so you have a slightly lower rate.

Senator HATCH. There was an article in the Wall Street Journal that suggested that a flat rate system would yield even greater rates of revenue.

Mr. RABUSHKA. It would, I've been working with a colleague at Stanford on designing one, trying to write some legislation for it because I think it would correct a lot of the problems we now have.

Senator DECONCINI. Excuse me, just a minute. What would be the effect if we had indexing of the income tax with the inflation rate today? Would that be how much of an alteration?

Mr. RABUSHKA. I think it would make a significant alteration. If we had real economic growth, all that indexing would do would be to correct the amount of tax increase due to inflation driven bracket creep.

Senator DECONCINI. Would that indexing work in a manner that would still not benefit the Government, at least for a short period of time?

Mr. RABUSHKA. It wouldn't solve the long-term problem. It will stop taxpayers from being pushed into significantly higher tax brackets as a result of nonvoting taxes more quickly.

I indicate in the Wall Street Journal that the Congressional Joint Committee on Taxation tried to calculate the impact of inflation running at something like 10 percent next year, then slightly lower rates over the next 2 years on the proposed Kemp-Roth, starting January 1, 1981, running for 3 years. It would eat up between 75 and 80 percent of those dollar gains. If you put the social security tax onto that, the inflation-generated tax increases, coupled with social security tax increases offset the whole of Kemp-Roth.

So, in fact, Kemp-Roth is not a tax cut. It's simply an offset of 3 years of tax increases. And most of this, three-quarters of it, is purely a consequence of inflation. Even if we went back to the period of the Eisenhower years, when it averaged about 1½ percent inflation, Government still grew.

The point I'm about to make is that we have had seven postwar tax reforms, reductions of one sort or another, and this has partially slowed the rising stream of Government having more and more of our income. But it hasn't completely corrected it; that is, they have been a sloppy substitute for indexing.

The real advantage of having a tax limitation provision in a constitutional amendment is to make sure that increases——

Senator HATCH. You're speaking about section 2?

Mr. RABUSHKA. Section 2, that's correct. It would neutralize the automatic tax increases that now takes place, and it would permit rises in taxation if and only if Congress so explicitly votes. Which is why I say it doesn't mandate any given level of taxation. It's not a statement dictating specific economic policy. It neither freezes the current level; it doesn't prevent higher increases; it doesn't prevent tax reduction. It simply says it cannot take place upward automatically, which is what has happened.

Senator HATCH. Without a vote of Congress. If Congress votes it will have to have a constitutional majority, which is certainly more than a simple majority.

Mr. RABUSHKA. That's correct. In fact, I note here that we fought the War of Independence on the theme of no taxation without representation. I see a measure like section 2 insuring no tax increases without voting. I think that's a very important modification.

I want to conclude, as I have on my formal statement here, on the idea that if you go back to the early Founding Fathers, it's quite clear to me that they never contemplated the size and growth of Government taxing that we have today. In fact, it's quite clear that one of the reasons we had the Constitution we had, and the war we had, was to make sure that we weren't going to get into this kind of situation, and that's why we really didn't have an income tax amendment until 1913.

I suspect that had they imagined this they would have put into the Constitution the necessary preventions so that it never could have occurred, but they didn't. How could they see 200 years ahead? And given we do have a 16th amendment, which is a specific vehicle for raising revenue, I see no inconsistency in having a constitutional

amendment which is, in effect, an antidote to that amendment. That really concludes my summary of my statement.

Senator HATCH. I appreciate that. Craig, do you have anything you care to add?

Mr. STUBBLEBINE. I'd be glad to respond to any questions.

Senator HATCH. Let me ask you this. As you know, one of the major concerns a number of us have, an issue raised during the markup, was the issue of section 4 and whether or not it be inconsistent with the 10th amendment to the Constitution.

Do you have any suggestions as to how we might tighten up this section?

Mr. RABUSHKA. Craig's had some experience with the spending limit amendment in California, which has a similar provision. I think he could probably speak to that better than I can.

Mr. STUBBLEBINE. I'm not sure I can speak to it on the basis of California's experience because actually the California Legislature has not attempted to end run that provision, under proposition 4, article 13B.

Senator HATCH. You said they tried?

Mr. STUBBLEBINE. They have not. The transgressions have occurred under an earlier statutory law adopted by the legislature, and they have willy-nilly gone around back. But there have been no real tests under the California constitutional amendment.

Let me respond to your question about section 4 in two parts: The first part is, I think, there is complete agreement among all concerned that section 4 is not designed to, in any way, intrude upon the 10th amendment provision. It's not designed to, in any way, to affect the balance of powers between the Federal Government and the State governments.

My own instinct is it probably could be taken care of simply in the legislative history; at the same time, to the extent that we can find explicit language which would guarantee that no intrusion on the 10th amendment is implied, certainly that would be desirous.

Senator HATCH. We might be able to expressly state that in the section itself. What about the "additional activities," language?

Mr. STUBBLEBINE. The second part has to do with activities. The criticism levied is that the Congress might be inclined to somehow get around that. My own reaction is that activities is, perhaps, the broadest generic term that one could bring into play.

Any activity, any action by the Congress, which has the effect of imposing additional costs on the States, would be met by Federal compensation. I can't think offhand, I can't think of any word that would be more inclusive than activity.

Senator HATCH. You are right, "activity" is a term that is broadly interpreted by most people. And Members of Congress are often innovative in their interpretations of legislative language.

I suggest that we discuss the issue with various constitutional scholars and see if they can help us formulate an all-inclusive phraseology that cannot be circumvented.

Mr. STUBBLEBINE. I have a sense, Senator, that somehow, behind some of these comments made by the witnesses and the Washington Post in its editorial, that, in fact, they would approve a larger intrusion of the Federal Government in the activities.

The example used in the Washington Post dealt with standardized polling times, which presumably would require some polls to be open longer times. And the Post took exception to the fact that somehow the Federal Government should compensate the States for having to keep their polls open a greater amount of time, as though this was somehow an instrusion on the Federal part.

My own reaction to that would be quite different. Presumably the purpose of standardized polling times is to fulfill some sort of national purpose with respect to biasing the outcomes of elections. That's a national purpose and it seems quite appropriate to me that should be in the national budget rather than the State budget.

So, this term "activities" somehow has to be defined in the legislative history in such a way that it makes it more inclusive rather than less inclusive. But again, the issue is addressed only to the additional costs brought upon the States. It's not an attempt to somehow reorganize the relationships between the Federal Government and the State government which has come into being at this point. So, it's the additional costs, the additional costs involving eastern polls being open another 4 hours.

Senator DeConcini. Professor, were you here when Mr. Weaver and Mr. Morris testified?

Mr. Stubblebine. I believe so.

Senator DeConcini. Do you have any comments particularly on Mr. Weaver's feeling that this is kind of a charade; that we're just going to build a way to force Congress to find a way around this measure? What is your observation?

Mr. Stubblebine. Well, as Senator Hatch suggested, of course, in the absence of an enforcement clause permitting intrusion of the U.S. Supreme Court, and who knows how they will treat them, the Congress will, of course, be the final arbiter of the meaning of the amendment.

The protection against arbitrary interpretation is going to be the legislative history that follows this amendment through the process of Congress. That is, in essence, the committee report of the Subcommittee on the Constitution. That will be the basic document, the basic interpretative document. The amendment and all of these issues should be addressed quite clearly, as clearly as possible in that document. So that the notion that somehow the Congress can willy-nilly get around this by simply redefining some of the terms I don't think is, in fact, a major issue.

Senator DeConcini. It certainly would seem to be extremely embarrassing. I don't think the media is always too kind on Congress; maybe for good reason. They would point it out, if Congress attempted to interpret it differently than the history has been laid down by these hearings and the hearings in Washington.

Mr. Stubblebine. Certainly. I have every sense that the subcommittee is taking the responsibility seriously on this issue, and they are, in fact, working on an amendment that they expect to be a permanent part of the Constitution.

There is no way in the end to prevent some subsequent Congress, with the support of the American people, from informally redefining an amendment. That's one thing you can't prevent. In a Constitution there is no set of words that will prevent a will of Congress or willing body politic from redefining the Constitution.

Mr. RABUSHKA. Or even repealing an amendment.

Mr. STUBBLEBINE. Informally.

Mr. RABUSHKA. Or formally.

Senator HATCH. We appreciate you gentlemen. We will put your full statements in the record. Thank you. We again appreciate your leadership.

We in Congress realize who the real leaders are. Thanks for everything. The fight has just begun so we need continued leadership.

Mr. RABUSHKA. It's nice finally to be in the country before at least a subcollection of your committee when you're in formal hearing.

Senator HATCH. Thank you. That is the end of our witnesses.

Senator DECONCINI. Could I just include in this record my gratitude to the Board of Supervisors of Maricopa County for providing the facilities. They have done this on many occasions in the past, and I'd like to thank Senator Hatch for taking the time from his busy schedule.

Senator HATCH. It's been a real privilege to be here in Arizona, Dennis. I appreciate your leadership on this issue. I'd like to express my appreciation to Maricopa County for their hospitality. With that we will recess these hearings.

[The prepared statement and additional articles submitted by Mr. Rabushka follow:]

PREPARED STATEMENT OF ALVIN RABUSHKA

Why the present concern for a balanced budget amendment? I must say I personally find it curious that the notion of a Constitutional requirement to balance the federal budget s regarded in some quarters as a ratical proposal, an unwanted limitation on the flexibility of the federal government to use fiscal policy in pursuit of economic goals. It is curious because until well into the twentieth century no one thought an unbalanced buget virturous. Throughout our history and that of many western nations, revenue estimates ere unvariably dealt with for expenditure estimates. It was generally believed that public expenditure should be fit to available public revenues and that revenues should not be extended to fit expenditure. Moreover, public det was regarded as undesirable, a thing to be reduced and eliminated if possible. The guiding principle was that government should aim to be self supporting. This implies the philsophy and a practice of balance budgets.

By the middle of the twentieth century, spending decisions have become increasingly divorced from constraints of revenue. The government now determines it spending priorities first, and than instructs the Treasury to get by taxation or borrowing whatever funds are necessary to cover the outlays. Since government is reluctant to increase taxes, borrowing have been the chief way to cover short falls. The result have been an accumulation of massive debts, rising rates of inflation induced by rapid monetary growth.

I am going to skip over to the middle of page three, here, in which I traced through some statistics on the rise of National debt, the pro-capital holdings on that National debt and a quotation from Professor Melser, from whom we will hear

more in a moment. But I do want to call you attention since I come from California to the history of taxables. I think its germaine to this discussion, nor are they new to American history.

The stamp act of 1765 was repealed by the English Parliament in 1766 only after great protest in opposition from the colonies. The subsequent tax on glass, paint, paper and tea imposed in 1767 met opposition and was subsequently repealed in 1770. Finally, the 1773 Tea Act produced the Boston Tea Party of December 16, 1773.

Today's assault on Government owes much to the land slide passage of proposition 13, accomplished holy outside the State Legislature and outside the established party system, indeed over their opposition. Congressional reluctance to eliminate deposits and reduce spending, thus reducing inflationary pressures is in my opinion the reason that many state legislatures have called upon Congress to implement article five of the Constitution for the purpose of an amendment to balance the Federal budget.

Some say that proposition 13 is an imperfect meat axx approach to limiting government taxing and spending, but it is the reason we are all here today. A fifty-one to fourty-nine percent vote on proposition 13 would not have had the same impact, nor is proposition 13 the end. Its really just the beginning. Paul Gayann and the spirit of 13 iniative movement have collected nine hundred thousand signatures to place a spending limitation measure on the California ballot. It is passes, this amendment would mean that California would conduct its public finances under the requirement both for a balance budget and the spending limitation. Moreover in March,Howard Jarvenson announced a campaign to place on the

ballot a measure to eliminate California's personal income tax, and inventory tax on business. And still another groups has begun an iniative campaign to eliminate the sales tax over a period of three years. Thats allmost all the taxes in California, incidently.

Interest in limiting government is not going to die easily, atleast not in California.

Well let me turn now to the consequencies of a balance budget amendment, and I want to treat these under four separate catogories. what I would call philosopher, philisophica, economic, political and practical. First the philosophica. The moral benefits of a balanced budget are not to be overlooked. A balance between taxing and spending means that you pay for what you get and that society must live within its collective means. A balanced budget is inelagist to the financial circumstances of the individual household or firm, which must live within firm budgetary limits. The balanced budget thus conceptually relates government finance to that of the typical family's budgetary practice. By restoring the length between spending and revenue, a balance budget would reestablish the historically proven norm in which public officials first determine what resources were available to government and against that constraint chose among the many competing claims on public spending. Finally, it would insure that the people know exactly how much it would cost in terms of taxes to finance federal programs.

What about the economic consequencies of a balance budget. First, a balance budget requirement forces Congress to weigh the cost of expenditure programs at the same time Congress takes credit for the benefits these programs provide. Second and even more important getting rid of the deposits gets rid of some of the

fuel for inflation. A pro-abition on deposits will contribute to price stability, to increase consumption in an investment spending by the private sector; to increase employment again by the private sector, and hence to hire real growth in the economy, which is in truth a painless way to generate additional tax revenues.

Thus, if politicians voted new spending programs, they would either have to eliminate all spending programs or raise additional taxes. Resistance to the elimination of existing programs are to tax increases, would discourage many new spending proposals, and their by eliminate the current bias toward overspending. It would end future deposits and eliminate the inflationary impact of new money creations, which has in passed years financed these deposits.

Critics amandatory balance in the federal budget, stress the loss of flexibility in the application of fiscal policy to economic goals. However these critics often overlook the very real cost to current and previously accumulated deposits, which have often been used to finance transfer payments rather than capital outlays. It must be pain to sustain the flexibility they desire. I believe a balanced budget would encourage efficient and responsible government and thus greatly outweigh any alleged loss of benefits from a reduction in fiscal flexibility. Let me turn now to the political issues which I have discovered on repeated visits here are often more interesting to audiences than economic issues.

Political values and political perceptions indeed are important determinates of government action. On this criterium a balanced budget amendment is especially attractive. Far more I think than some of the more complicated spending limitation measures now pending. Most important its easy to understand. Every housewife and consumer understands the need for living within one means. Not only is the balanced budget concept wide-

ly understood, it is also widely supported. The more recent gallop pole shows that the public favors a balanced budget by a margin of six to one. In the crest for greater control on government deposit spending, an incomodent inflationary pressures the simple idea of the balanced budget looks like a more sailable package, than the more complicated spending limitation measures, and I for one would not want the perfect to be the enemy of the good. Again to California for the illustration.

Proposition 13 has been and still is described as a meat axe approach to tax limitation, but it was a simple measure. Voters could look at pass assessment notices and immediately calculate their tax savings. Indeed it may be one of the few times in the history of this country that you could walk into a ballot box, pick up a little pen, punch a hole and be pretty sure you were going to walk away with atleast a thousand dollars in cash. There are'nt very many times you get to vote yourself a thousand dollars. By contrast, Governor Ragans ill faded proposition one of 1973, a spending limitation measure was more complicated, more difficult to understand and support, and indeed it lost by a fifty-four fourty-six margin. I should remind you that proposition won by almost a two-thirds majority.

Well let me turn to some practical considerations here. The workability of a balanced budget amendment. I think a sensible amendment might allow some budget surpluses to be retained as financial reserves, up to say some authorized share of annual spending. These reserves than could be drawn down to make up revenue short falls in any one year due to recession. And ofcourse any sensible amendment would also contain an emergency escape hatch, in case of serious recession, say, a two-thirds vote of Congress could be marshall to declare an emergency, and thus suspend the privision of balance for that year.

Critics note that a balance budget need not prevent future increases in federal spending. However the need to raise more taxes to finance more spending makes it difficult to sustain the recent high rates of growth in new spending. A balance budget would require tax increases to be explicitly voted rather than implicitly imposed by deposits spending and inflation, and I know a few politicians today who want the campaign on a platform of higher tax rates.

Well let me turn now to a brief comparasion between the balanced budget concept and the spending limitation concept. Consider first the balanced budget requirement, which requires that revenues and expenditures be in rough balance on some year to year basic. New spending would be matched by new taxes or terminating old spending. In the current climate of opinion it would be very difficult to raise taxes, thus a balanced budget implies some limitation on spending. For sure the requirement of balance means that the Federal budget deposits will no longer be the inflationary force they have been since the mid 1960's. In short, a balanced budget eliminates deposits, lowers inflationary pressures and all likelihood cramps new taxing and spending proposals as well.

Now turn to a spending limitation measure, however conceived. Even with a Constitutional Amendment to limit spending, the federal budget can sustain future deposits. Some people have developed projections which show that in the presence of spending limitation movement, inflation or economic growth will produce a balanced budget. Thats ofcourse because our progressive tax system we do have a rise in tax revenue greater than the rate of growth in the gross national product. But this could prove false if Congress voted a suscessive series of tax reductions. Thus a spending limitation would not preclude suscessive tax reductions which could inturn generate the deposits which have lead to new money creation.

There is yet one other draw back with many of the spending limitations measures thus far proposed. They are invariablely cumbasome and to complexed. Scholarly research shows that complexed proposals tend to lose support as en election approaches, in direct proportion to the complexity of the proposals. This has certainly be true at the level of some of the state measures. I am saying than, that a balanced budget proposal is more likely to obtain both necessary Congressional and Public support as opposed to the more purely spending limitation measures.

There does remain residural fear that a balanced budget requirement will lead to Congress to raise taxes. But one could I think restrain this tendency by specifying some upper limit on government spending as a sure of gross national product. And in truth I want to conclude on the thought that I don't see anything inherently contriditory between merging a limit on government spending into a balanced budget requirement. In fact I have found one Senate joint resolution which attempt to do this. I know other, two of us in this room have tried our hands including myself adrapting a balanced budget amendment. And I think it is possible to merge a balanced budget and a spending limitation that would both limit the size of government to its present level, permit reductions in the size of government through the enacting of tax cuts and appropriately spending reductions mandated by a balanced budget, and within an escape clause suspend these privisions in case of true emergency. This would in the process I believe eliminate the inflationary pressures of federal deposits. As political scientist I would also think it would change the character of political life much for the better.

Tax and Spending Limits

Alvin Rabushka

IV

No issue is more salient in contemporary American politics than limiting taxes and controlling government spending. Landslide passage of Proposition 13 on June 6, 1978, highlighted public outrage over rising taxes and the seemingly uncontrollable runaway growth of government spending. Proposition 13 was a contagious phenomenon. On election day in November 1978, eight states approved new tax limitation measures, and three additional states authorized spending limits.

Nor is Proposition 13 the end. Paul Gann and the "Spirit of 13" Initiative movement have collected 900,000 signatures to place a spending limitation measure on the California ballot that would tie increases in state and local government spending to increases in the consumer price index (CPI) and population. If this amendment is adopted, California will be required to balance its budget and to limit its spending. Moreover, in April 1979 Howard Jarvis announced a campaign to place on the ballot a measure to halve California's personal income tax, index the income tax to the CPI, freeze the state sales tax at its present level, and eliminate the inventory tax on business. Another group has begun an initiative campaign to eliminate the sales tax over a period of three years. Proposition 13 is not the end of limiting taxes and governmental spending in California.

Movements are under way in other states and localities to roll back or freeze taxes and to place caps on government expenditures. Election day in 1980 will probably witness another dozen or more statewide referenda on issues of tax and spending limits.

Nor is the movement to limit taxes and spending confined to state and local governments. Several organizations and individuals have launched campaigns to restrain federal spending. The National Taxpayers Union has worked with many state legislatures to petition Congress to invoke

Article V of the Constitution and call a constitutional convention to draft an amendment requiring a balanced federal budget. Another organization consisting of prominent academics and public officials, the National Tax Limitation Committee, has drafted an amendment to limit federal spending (known as the Friedman amendment after Professor Milton Friedman). Howard Jarvis, co-sponsor of Proposition 13, has launched his own nationwide American Tax Reduction Movement. His plan seeks to reduce taxes by $50 billion, set a 15-percent limit on the capital gains tax, cut $100 billion from the federal budget over a four-year phase-in period, and retire the national debt by reducing spending more than taxes.

Hundreds of members of Congress have sponsored joint resolutions to require a balanced federal budget, place a limit on the share of gross national product (GNP) that the federal government can spend under normal circumstances, reduce the share of national income that the federal government can spend, or require that the federal government be constrained both by a spending limit and a balanced budget requirement. No issue commanded more congressional attention in spring 1979 than the balanced budget/spending limit movement.

Congressional interest in the balanced budget amendment will probably increase as the number of states petitioning Congress nears the two-thirds required by the Constitution, but is likely to shift to more pressing business if the movement begins to die. Whatever the outcome of the various campaigns, voters in more and more states will undoubtedly place constraints on taxes and spending.

Public opinion polls reveal a growing consensus that government must be restrained, that the direction of government spending, regulation, and taxation must be reversed in order to preserve our democratic processes and free enterprise economy. Public opinion no longer supports further expansions in public spending. Now more than ever, higher percentages of Americans say that taxes are too high, that the government wastes tax money and can no longer invariably be trusted to act correctly. Sixty percent of Americans regard inflation as the most important national problem, and, according to Gallup, 80 percent favor a constitutional amendment to require a balanced budget.

Proposition 13 may have inspired the current tax revolt, but opposition to taxes is firmly rooted in American history. The notorious Stamp Act of 1765 was repealed by the English Parliament in 1766 because of colonial protest and opposition. A substitute tax on glass, paint, paper, and tea, imposed on the colonies in 1767, met equally vociferous opposition and was subsequently repealed in 1770. The infamous 1773 Tea Act gave rise to the Boston Tea Party. Historians record the

revolutionary war cry as "No taxation without representation!" but I suspect that "No taxation!" may be closer to the truth.

Despite these early tax revolts, government spending and taxes were not burdensome until well into the twentieth century. In 1902, for example, federal spending constituted less than 3 percent of GNP, and government spending at all levels accounted for only 8 percent of GNP. In 1978, in contrast, the respective shares had risen to 22 and 33 percent, an eightfold increase for the federal government and a fourfold increase for all levels of government. In a few years, the national debt will exceed one trillion dollars, mostly because of deficit spending in normal, peacetime circumstances.

THE GROWTH OF AMERICAN GOVERNMENT IN THE TWENTIETH CENTURY[1]

As just noted, government spending in 1902 constituted only a modest share of GNP or personal income. Between 1902 and 1913, total government spending as a share of GNP remained almost constant at 8.8 percent. But then began an incredible burst in public spending. Between 1913 and 1932, government revenues doubled as a percentage of GNP, and government spending more than doubled. This growth was due in part to passage of the Sixteenth Amendment (the income tax) and World War I with its related expenditures.

In 1929, the date for which national income and product accounts are first available for the United States, total government spending was about 10 percent of GNP and about 12 percent of personal income (see Table 1). These percentages grew steadily and reached nearly one-third of GNP and 40 percent of personal income by 1978. The composition of this spending has also shifted; the federal share has increased from about one-quarter to just over two-thirds.

The increase in federal spending has outpaced the growth of federal revenues, resulting in a massive deficit. Before World War I, the federal debt stood below $2 billion. It grew to $24 billion after the war, increased to $43 billion during the New Deal–depression years, and exploded to $260 billion by the close of World War II. About $23 billion was added to the federal deficit between 1947 and 1965. In the next decade, the total was $148 billion. Between 1976 and 1979 alone, the deficits exceeded $200 billion.[2]

By the end of fiscal year 1980, gross federal debt is expected to reach $899 billion, of which $690 billion will be held publicly. This latter sum is equal to $3,100 per capita. Interest on the federal debt is projected at $57

TABLE 1

Growth of Government Spending (billion $)

Year	GNP	Personal Income	Federal Spending	Total Government Spending*	Total Government Spending as Percentage of GNP	Total Government Spending as Percentage of PI
1929	103.4	84.9	2.6	10.3	10.0	12.1
1939	90.8	72.4	8.9	17.6	19.4	24.3
1949	258.0	205.6	41.3	59.3	23.0	28.8
1959	486.5	382.1	91.0	131.0	26.9	34.3
1969	935.5	745.8	188.4	285.6	27.6	38.3
1978	2,106.6	1,707.3	461.0	684.2	32.5	40.1

Source: *Economic Report of the President* (Washington, D.C.: Government Printing Office, 1979): Table B-72, p. 267; Table B-17, p. 202; Table B-18, p. 203.
Note: *Includes federal, state and local governments.

billion, or $260 per capita. Interest payments are the third largest item in the federal budget and consume 9¢ of every budget dollar.

Large and accumulating budget deficits make limiting monetary growth more difficult. The greater the amount of money issued to finance the deficit, the higher the subsequent inflation. Between 1947 and 1967, an era of only modest budget deficits, the inflation rate averaged just 1.6 percent; in contrast, the average rate from 1967 to 1977 was 7 percent, and has accelerated to better than 9 percent in 1978–79.

Until 1973, the growth in government spending was accompanied by a steady rise in real private income. Since 1973, growth in real private income has fallen off dramatically. As a result, the public is increasingly concerned over its total tax burden and the aggregate amount of government spending.

What are the facts?[3] Between 1947 and 1973, real disposable income per capita grew on average 2.5 percent per year (and nearly doubled during this period). In contrast, between 1973 and 1977, the rate fell to 1.3 percent per year. But this growth figure of 1.3 percent is somewhat misleading as a measure of private economic well-being because it omits both the rapid increases in the labor force participation rate and the enormous government deficits that accumulated in this five-year period.

The 1970s have seen rapid growth in labor force participation. Although real disposable income per worker grew by an annual rate of 3 percent between 1947 and 1973, the corresponding figure for 1973 to 1977 is 0.3 percent (five million more workers joined the labor force in this period). And if we construe the issuance of debt as a postponement of taxes, real disposable income less increased federal debt per worker fell by 0.3 percent per year. Since 1973, real economic growth has slowed substantially, and virtually all real economic growth has gone into increased government spending—trends that readily promote a taxpayer revolt. It is inconceivable that taxpayers want all of this modest growth to be spent by government.

The growth of government spending has been accompanied by declining public confidence in government. Surveys conducted by George Gallup, Louis Harris, the Institute of Social Research at the University of Michigan, and CBS/New York Times reveal major shifts in public opinion between 1957 and 1978, the year of the tax revolt.[4] The percentage of respondents who said that government wastes money rose from 46 to 80. But the number of those who said they trust Washington to do what is right most of the time declined from 75 to 34 percent. Although Americans have never been enthusiastic about paying taxes, compared with ten years ago, higher percentages today feel that their income and property taxes are too high.

Americans are increasingly feeling the effects of inflation. Between 1958 and 1973, for example, the number of Gallup's respondents naming inflation as the nation's most important problem was always less than 20 percent. Since 1974, the percentage has ranged from a low of 25 to a high of 79. Complaints about taxes and government waste have escalated as taxpayers endure rising rates of inflation and stagnant real income. The movements to limit taxes and spending are visibly rooted in reason, not caprice.

CALIFORNIA: BLUEPRINT FOR THE FUTURE

Proposition 13 exploded on the American political scene. Given California's modest initiative requirement and its lively political culture, it is not surprising that the tax revolt should surface there. Briefly, Proposition 13 limits taxes to 1 percent of market value, computed initially on the basis of the 1975–76 assessment rolls, with a maximum 2 percent assessment increase annually. At time of sale, the property can be revalued based on actual market price. Proposition 13 immediately decreased local governments' property tax receipts by $7 billion, or 57 percent. It also requires a two-thirds vote of the state legislature to increase state taxes, and local governments may impose special taxes (except property taxes) only after approval by two-thirds of the jurisdiction's voters.

However, the Jarvis-Gann initiative to gain property tax relief and "send the politicians a message" followed a decade of unsuccessful initiatives to reduce property taxes or government spending. What changes, then, brought about Proposition 13's overwhelming success?

Property tax reform and spending limits have been part of California history since the mid-1960s.[5] A bribery scandal in 1965 prompted reform to ensure a uniform statewide ratio of 25 percent between a property's assessed value and its market value. This reform actually increased the burden on single-family housing since commercial properties had previously been paying a disproportionately high burden of the tax bill. The resultant increase in homeowners' tax bills motivated the Watson Initiative, or Proposition 9, on the November 1968 ballot. This amendment proposed limiting taxes to 1 percent of a property's current market value for property-related services (public safety, general government, etc.) and also gradually eliminating the use of property tax revenues for people-related services (education and welfare). Opponents of Proposition 9 forecasted massive increases in income and sales taxes to offset declines in property tax revenues. Meanwhile, the state legislature

passed a more moderate tax relief alternative, California's first homeowner's exemption. Watson lost by more than two-to-one, and the homeowner's exemption passed by a slight majority. Analysts of the vote concluded that California voters felt the 1960s were good years and thus were not predisposed to vote against taxes.

Subsequent measures fared no better than the Watson initiative. In 1970, for example, Howard Jarvis failed to obtain the necessary signatures to place a somewhat standard tax limitation initiative on the ballot. But in 1972, Watson qualified a second initiative (Proposition 14) for the ballot. It proposed to substitute increases in sales, liquor, cigarette, and corporate income taxes and state funding of education and welfare to compensate for property tax relief. Despite the deteriorating economic climate and the beginnings of steady increases in assessed values for single-family housing, Watson again got only one-third of the vote.

In November 1973, Governor Reagan proposed a limitation on public spending (Proposition 1). The proposed amendment linked growth in state expenditures with the growth rate in personal income and required that future increases in tax rate schedules receive a two-thirds vote of the legislature. Governor Reagan proposed this spending limit after raising the maximum tax rate on personal income from 7 percent in 1967 to 11 percent in 1971, with somewhat smaller 2 percent increases in the tax rates for corporations and banks.

Proposition 1 lost by a 56–44 percent margin. Analysts of the election believe that the proposal was unclear and cast in difficult technical language and that public dissatisfaction with the level of government spending was still low.

After 1973, California's tax climate, especially property taxes, changed dramatically.[6] A period of rapidly accelerating housing prices sharply increased property taxes. Between 1973 and 1978, the year of Jarvis-Gann, housing prices in California grew more rapidly—often two to three times as fast—than in most other major urban areas. Thus, many families were paying property taxes well in excess of what they had anticipated. Property tax bills increased far more rapidly than homeowners' disposable income.

Not only were property taxes accelerating, but by 1976–77 California ranked third after Alaska and New York in state and local tax collections per $1,000 of personal income. In all, California governments took 15.5 percent of their residents' personal income in 1976–77 (compared with 9.3 percent in 1957). The state's property tax receipts per $1,000 of personal income were 41 percent above the national norm, and the share of property taxes accounted for by single-family dwellings rose dramatically after 1973.

Still, two attempts to place property tax limitation initiatives on the 1976 ballot, one by Watson, one by Paul Gann, could not obtain the necessary number of signatures.

Rapidly rising assessments meant that local governments could enjoy rising property tax receipts without raising tax rates—indeed, the average combined tax rate for homeowners fell by nearly 5 percent between 1974 and 1978, but assessment increases more than doubled. Throughout the mid-1970s, local government spending, fueled by the tax yields of rampant housing inflation, grew about 10 percent per year. In the early 1970s, legislation to set maximum tax rates was ineffective in holding down tax bills since it was rising assessments, not rising tax rates, that increased the tax burden.

But perhaps the most interesting elements in the chronicle of Proposition 13 were the state budget surplus and the legislature's inability to produce a major tax relief program. When Governor Brown took office in 1975, the state had a surplus of less than $400 million. By June 1978, this had grown to $6 billion, with prospects of passing the $10 billion mark by fiscal year 1979–80 if Proposition 13 were not passed. Since the state's personal income tax is steeply progressive, increases in personal income due to inflation translate into even larger proportionate increases in state tax receipts. Every 1 percent rise in personal income increases income taxes by 1.7 percent. With taxable income typically rising 10 percent per year during the late 1970s, state tax receipts rose 16 to 17 percent per year. Thus, high rates of inflation coupled with a strong statewide economy generated an enormous surfeit of tax receipts and a budgetary surplus fast approaching unreasonable dimensions. Despite the surplus and rising taxpayer resentment, the state legislature did not pass a meaningful tax relief program. Howard Jarvis and Paul Gann were able to qualify their initiative petition in one month.

In early 1978, the state legislature proposed a less drastic rival measure, but it was too little, too late. Proposition 8, which would have separated the rolls for residential and commercial property taxes, but provided less current or future tax relief, failed to gain a simple majority in the June primary election. Proposition 13 won by an overwhelming 65 percent majority.

What was the message of Proposition 13? Was it, as some authors claim, simply a lashing out against inflation? Was it a protest vote against big government? Was it a complaint against government waste? Or was it simply a desire to cut taxes?

The California Poll, conducted by Mervin Field, revealed that voters believed that both taxes and waste could be cut with no serious reductions in the provision of essential services.[7] Seventy-three percent

of the California electorate rated the state government as "very" or "somewhat" inefficient, and majorities labeled county and city governments and school boards equally inefficient. A majority of voters even said that small budgetary cutbacks would have no effect on the provision of local services.

In view of the escalating state surplus, many Californians not surprisingly believed that property taxes could be cut without jeopardizing public services. Even so, 41 percent wanted less spending on public housing, and 62 percent wanted cuts in welfare. Fifty-eight percent of those polled in June 1978 said that in place of the present budgetary system, they wanted to set a limit on state spending.

Support for Proposition 13 encompassed partisan, ideological, and social class differences. Majorities in virtually every class of the population voted for the measure. The public services that voters want cut back most are income redistribution programs that provide few benefits to middle-income taxpayers; those services voters want maintained or expanded serve middle-income taxpayers. Proposition 13 can be interpreted, at least initially, as an anti-tax, anti-government, anti-inflation, anti-income-redistribution gesture of taxpayers, and of homeowning taxpayers in particular.

FALL 1978: THE TAX REVOLT SPREADS

Forty-seven states, Puerto Rico, and the District of Columbia have either a constitutional or statutory prohibition or restraint on state deficit financing, some dating from the nineteenth century.[8] These provisions either restrict the ability to incur debt, require balanced budgets or appropriations, or provide for the management of an impending or already incurred deficit. However, these constitutional and statutory prohibitions on state deficit financing have not prevented rapid growth in state taxing and spending, due largely to inflation and progressive tax rate schedules.

Although 1978 is recognized as the year of the tax revolt, movements to limit state spending and taxing began to appear on state ballots during America's bicentennial year, 1976. Five states (Michigan, Utah, Colorado, Florida, and Montana) had propositions to limit taxation. Despite failure in every case, these movements presaged the vastly greater number of tax and spending limits that surfaced in 1978.

Tennessee voters were the first to adopt an explicit limit on spending; on March 7, 1978, its voters approved by a two-thirds majority an amendment limiting the rate of growth of state spending to the state's

economic growth rate. (Perhaps New Jersey deserves credit as the first state to adopt stringent limitations on state and local government spending. In 1976, the state legislature limited increases in state spending to the annual per capita increase in wealth [about 10 percent per year] and set local government caps at 5 percent per year. Adoption of these limits did not require voter approval. In 1977 the Colorado legislature enacted a statute that limited spending increases to 7 percent per year until 1983.) Then the dramatic and highly publicized success of Proposition 13 inspired a number of similar initiatives in more than a dozen other states.

Although twenty states voted on some form of tax or spending measure, the issue in six states was not so much limiting as shifting the burden of taxation or changing the rules for assessments. In Illinois, for example, the property tax ceiling referendum was purely advisory. Massachusetts voters authorized cities and towns to tax residential property at lower rates than commercial property. Missouri voters, in anticipation of property reassessments, authorized their legislature to require local governments to reduce tax rates to hold down property taxes. Montana voters rejected a plan to transfer assessments for property taxes from the state to local governments.

South Carolina, which already operates under a balanced budget requirement, now manages its fiscal affairs under an additional constraint: its voters authorized the establishment of a "rainy day" reserve fund equal to 5 percent of the general budget to be used for emergencies only after a two-thirds vote of the legislature. Finally, in Colorado, voters rejected a plan to liberalize the 7 percent statutory spending limit with one tied to inflation, which at the time exceeded 7 percent.

Table 2, the box score for the 1978 state referenda, is divided into spending limits and tax limits. A similar pattern of voting emerges from both tax and spending limitations. Majorities favoring tax and spending limitations exceeded, on average, majorities rejecting limits. Oregonians flirted with adoption of a Proposition 13–type limitation on property taxes. Other No votes in Oregon and Arkansas won by modest majorities. In contrast, the percentages approving new tax limits ran as high as 84 percent in Texas, and in only two instances were less than 55 percent.

Overall, the voters' message was clear: runaway government spending and taxing must be limited. But due to variations in the limits imposed and in the perceived efficiency of public spending, the availability of surpluses, and the effectiveness of interest groups, it is difficult to draw general conclusions about the measures that failed, save to note their small margin of defeat.

Organized efforts are under way to put tax and spending limits on the 1980 ballot in other states. These proposals will differ among states, reflecting local goals and economic conditions. Most measures will appear in states that already have constitutional or statutory requirements for balanced budgets. State and local governments thus begin the 1980s bound under fiscal constraints that may affect the quantity and quality of public services, but definitely limit their powers to tax and spend. Government growth in the 1980s will not rival that of the 1970s.

1979: A YEAR OF BALANCED FEDERAL BUDGETS AND SPENDING LIMITATIONS

Before 1900, the government of the United States was rarely troubled with budget deficits. Rapid economic growth throughout the nineteenth century generated sufficient revenues, primarily from customs duties, to finance federal spending. Although deficits sometimes occurred due to economic decline or war, budgetary surpluses in good years quickly restored the overall balance. These infrequent deficits were clearly viewed as exceptions from the principle of fiscal balance, and corrective measures were invariably promised and soon taken to restore normal conditions. As a result, the real value of government debt per capita in 1891 was about the same as in 1791.

The philosophy that government should be self-supporting implied a practice of balanced budgets. In the event, the frequent surpluses made federal borrowing a rare event. Revenues and expenditures were not incorporated into an overall official federal budget until 1921, but the presence of a budgetary surplus each year during the 1920s suppressed debate on a statutory or constitutional requirement for a balanced budget.

During the past 50 years, however, the federal budget was balanced only nine times and only once in the past 20 years. The outcome is one-sided: $626 billion in deficits and only $34 billion in surpluses. In 1977, real debt per capita was 23 times greater than at the start of the century.

Although President Roosevelt campaigned in 1932 on a balanced budget platform and several bills were introduced in Congress in 1936 to balance the budget, national interest lay dormant until 1975 (with the exception of the Eisenhower years). In that year the Senate Judiciary Committee held hearings on balancing the budget, from which arose the movement led by the National Taxpayers Union to mobilize state

TABLE 2

1978 State Limitations

Part One: Spending Limitations

Approved

Arizona (state spending limited to 7 percent of total personal income; half of state money to be exempt from the limit; emergency increases allowed with approval of two-thirds of legislature)

Yes	382,031	78.2 percent
No	106,684	21.8
	488,715	Turnout = 29.8 percent

Hawaii (state spending can increase only at rate of increase of state economy; limitation on state bonded indebtedness; tax refunds or credits made if general fund has a surplus exceeding 5 percent of revenues for two consecutive years)

Yes	168,508	66.8 percent
No	83,718	33.2
	252,226	Turnout = 39.6 percent

Defeated

Nebraska (local governments and school boards can increase spending by more than 5 percent per year only if four-fifths of state legislature approves or population or enrollment increases by more than 5 percent)

Yes	203,474	44.8 percent
No	250,357	55.2
	453,831	Turnout = 40.6 percent

Approved			Defeated		
Alabama (restricts increases in all kinds of property taxes in any county to 20 percent; different kinds of property assessed at different rates)			North Dakota (reduces income tax rates for individuals, increases them for corporations; new tax rates would require approval by two-thirds of legislature)		
Yes	313,577	60.4 percent	Yes	127,280	65.1 percent
No	205,782	39.6	No	68,215	34.9
	519,359	Turnout = 19.9 percent		194,495	Turnout = 42.4 percent
Idaho (limits property taxes to 1 percent of current market value; two-thirds vote of legislature required to impose any new tax)			South Dakota (two-thirds vote of legislature required to raise sales tax on real property tax)		
Yes	162,486	58.4 percent	Yes	113,901	52.9 percent
No	115,737	41.6	No	101,207	47.1
	278,223	Turnout = 46.6 percent		215,108	Turnout = 44.4 percent
Michigan ("Headlee Amendment" to limit taxes to current percentage [9.5 percent] of state personal income; ties property tax increases to level of inflation; requires voter approval of all new tax increases and bond issues)			Texas (increases homestead exemptions, reduces taxes on the elderly, reduces farm and timberland taxes)		
Yes	1,444,456	52.5 percent	Yes	1,550,234	84.1 percent
No	1,307,989	47.5	No	293,233	15.9
	2,752,445	Turnout = 43.0 percent		1,843,467	Turnout = 20.3 percent
Nevada (limits property taxes to 1 percent of current fair market value, prohibits assessment increases of more than 2 percent per year)			West Virginia (allows school taxes and bonds to pass by simple majorities instead of present requirement of 60 percent)		
Yes	140,310	77.8 percent	Yes	141,743	43.8 percent
No	40,109	22.2	No	181,906	56.2
	180,419	Turnout = 39.1 percent		323,649	Turnout = 24.1 percent

Defeated		
Arkansas (repeals 3 percent sales tax on food and prescription drugs)		
Yes	223,004	45.0 percent
No	272,086	55.0
	495,090	Turnout = 32.3 percent
Michigan ("Tisch Amendment" to limit annual property tax increases to 2.5 percent)		
Yes	1,025,824	37.3 percent
No	1,723,968	62.7
	2,749,792	Turnout = 42.9 percent
Oregon (legislative referendum on more relief to homeowners and renters, but no relief for business)		
Yes	382,280	45.1 percent
No	465,746	54.9
	848,026	Turnout = 48.5 percent
Oregon (limits property taxes to 1.5 percent of market value)		
Yes	422,139	48.3 percent
No	451,985	51.7
	874,124	Turnout = 49.9 percent

Source: *Public Opinion*, November/December 1978, p. 28.

legislatures to call a constitutional convention to require a balanced budget. Five state legislatures approved balanced budget resolutions in 1975. By May 1979, the number had grown to 30, four short of the two-thirds required.

Economic trends and the political temper of the times have made the balanced budget an issue with tremendous popular appeal. The public believes that chronic deficit spending causes several harmful consequences: inflation, decreases in private spending and investment, and increases in interest rates, with reduced investment in capital goods.

Another movement seeks an amendment limiting federal spending. In July 1978, a number of distinguished economists and public servants formed the National Tax Limitation Committee to work on a proposed constitutional amendment to limit federal spending. A draft of the amendment was released in Washington, D.C., on January 30, 1979, and offered in Congress by Senators John H. Heinz and Richard Stone several months later. The amendment seeks to limit increases in total government outlays to the percentage increase in nominal GNP of the last calendar year preceding the current fiscal year. If inflation exceeds 3 percent, the permissible increase in total outlays is reduced by one-fourth of the excess of inflation over 3 percent. The amendment further stipulates that fiscal surpluses be used to reduce the public debt of the United States. It also permits declarations of emergency, allows increases in total outlays if approved by a three-fourths vote of Congress and a majority of state legislatures, prevents reductions of grants to state and local governments, and contains an enforcement provision.

THE BALANCED BUDGET AMENDMENT: PROS AND CONS

Proponents of a balanced budget amendment couch their support in normative, economic, and political terms. The moral benefits of a balanced budget are not to be overlooked. A balance between taxing and spending means that society must live within its collective means. A balanced budget is analogous to the financial circumstances of an individual household or firm. The balanced budget thus conceptually links governmental finance and the average family's budgetary practice.

A balanced budget amendment would solidify the link between spending and revenue. It would compel public officials to determine first what resources are available to government and, against that constraint, choose among the many competing claims on public spending. It would

ensure that the people know exactly how much it will cost in terms of taxes to finance federal programs.

What are the economic consequences of a balanced budget amendment? It is generally acknowledged that spending programs are more popular with the voters and Congress than higher taxes. Thus, a balanced budget requirement forces Congress to weigh the costs of expenditure programs while allowing Congress to take credit for the benefits these programs provide. An amendment is deemed necessary because such modest reforms as the Congressional Budget Act of 1974 only marginally curbed the federal government's propensity for deficit financing.

Most important, a prohibition of deficits will reduce inflation. It will, as well, contribute to price stability and to increased spending by the private sector, increase after-tax returns to capital and labor, slow depreciation of the dollar in foreign exchange markets, and prevent massive new outbreaks in spending except in emergencies. A balanced budget will be excellent therapy for national inflationary psychology; it will help end the bias toward borrowing and spending.

Under the amendment, if politicians voted new spending programs, they would have to eliminate old programs or raise additional taxes. Resistance to the elimination of existing programs or to tax increases would discourage many new spending proposals and eliminate the current bias towards overspending. It would end future deficits and eliminate the inflationary effect of new money creation, which has in past years financed these deficits.

Although some regard any tax increase as inherently undesirable, a balanced budget amendment still permits an increase in public spending if there is an overriding democratic consensus. In practical terms, however, and in the current era of tax revolts, few politicians will want to campaign on a platform of higher taxes to finance more spending. The balanced budget will require that tax increases be explicitly voted, rather than implicitly imposed by deficit spending and inflation—this will effectively constrain new government spending.

Political values and perceptions are important determinants of government action. For this reason, a balanced budget amendment is especially attractive. It is easy to understand—every housewife understands the need for living within her means. It is also widely supported. Polls show overwhelming support for a balanced budget, often by margins of six-to-one.

Most supporters of the balanced budget amendment are keenly aware of practical difficulties in its implementation. Every proposed

amendment contains an emergency escape-hatch clause, based on some declaration of emergency and a two-thirds or greater vote by Congress, to suspend the requirement in the event of war or serious economic downturn. Some proposed amendments suggest the creation of a "rainy day" reserve fund from budgetary surpluses for periods of temporary deficit. Others suggest that a small unplanned excess of, say, 2 percent be permitted under the balanced budget requirement and that any sum over 2 percent be treated as outlays of the next fiscal year.

Although practical difficulties are acknowledged, most proponents regard continuation of present fiscal policy—deficits and concomitant inflationary pressure—to be far more dangerous than grappling with the implementation of a balanced budget constraint.

Opponents of a balanced budget amendment fall into two camps: those who prefer a spending limitation and those who oppose a constitutional restraint on fiscal flexibility.

Professor Milton Friedman exemplifies the first view. He contends that drafting a technically satisfactory amendment in order to achieve a balance over a period of good and bad years is difficult. What would happen if any reserve fund ran out in the face of unforeseen deficits? A constitutional limitation on spending, in his view, avoids this pitfall and effectively achieves his target of limiting the future growth in government spending.

Professor Paul Samuelson takes the second position and argues that economics is an inexact science and that it would be unwise to freeze policy rules for the indefinite future and thereby limit the flexibility required to deal with future problems.[9] Moreover, in his view, the present system of American democracy can cope with any national trend toward unreasonably large government. And if the escape clause is too lenient, the amendment becomes only a pious resolution cluttering the Constitution.

Other criticisms of a balanced budget highlight its conceptual difficulties. What does "outlays" mean? How does one prevent the emergence of "off-budget" spending or the separation of current and capital expenditures now found in several state budgets? How does Congress cope with the general unreliability of economic forecasts? What are the appropriate enforcement provisions if a projected balanced budget becomes unbalanced in the course of the fiscal year? How and by whom will the budget subsequently be made to conform to the constitutional prohibition?

My purpose is not to consider the pros and cons of a constitutional convention. But the passage of such resolutions by 30 states by May 1979 makes the issue of a balanced budget pressing.

A SPENDING LIMITATION AMENDMENT: PROS AND CONS

Proponents of a spending limitation often advance the same arguments as those who advocate a balanced budget. The fundamental defect in present budgetary procedure is that Congress considers spending programs on a piecemeal basis and the public cannot express its views on the size of the budget.

The major objective of a spending limitation amendment is to link the growth of government to growth in the private economy, either in terms of GNP, personal income, or changes in the CPI. Specific clauses could allow for upward or downward adjustments in the level of government spending to cope with emergencies.

Advocates of the National Tax Limitation Committee amendment (the Heinz-Stone amendment) emphasize its feasibility for limiting government. The amendment adeptly avoids the major pitfall of the balanced budget. Since outlays are based on the calendar year preceding the current fiscal year, spending growth is based on actual data and not economic forecasts. The 21-month difference between the fiscal year and the calendar year on which it is based incorporates, in the view of its advocates, an automatic countercyclical element in federal spending. Slow economic growth will slow federal spending 21 months later when the economy may be booming. Conversely, rapid economic growth will increase government spending 21 months later when the economy will most likely be slowing down.

The Heinz-Stone amendment also contains a strong incentive to reduce inflation. A rate of inflation above 3 percent cuts into the share of government spending. Thus, to maximize its real spending, the government would attempt to minimize inflation. The link between real economic growth and government spending would encourage more federal interest in promoting economic growth.

Critics of a spending limitation are again of two minds. One group opposes any constitutional limitation on federal fiscal policy or flexibility. The second claims that a balanced budget amendment is superior to a spending limitation.

There is nothing inherent in a spending limit that prevents future deficits. Projections showing that inflation or economic growth will produce a balanced budget under a spending limitation (because under our progressive tax structure, tax revenues increase faster than GNP) will prove false if Congress votes tax reductions. Thus, the pressure on monetary inflation would not necessarily be eliminated.

Another defect of many of the proposed spending limitation measures is their complexity. Typically complex proposals lose support as ratification nears. Moreover, some critics object to the inflexibility of these measures, which would prevent desirable increases in expenditures unless a state of emergency is declared.

TRENDS IN THE 1980S

Tax and spending limits are the culmination of the past fifteen years of high inflation, rising taxes, runaway government spending, and the simultaneous recognition that higher and higher levels of public spending do not readily solve social problems. All levels of government grew rapidly in the past few decades; in the 1980s, in contrast, they will face both growing public pressure against and new constitutional constraints on government growth. Forty-seven states already enjoy some constitutional or statutory prohibition of or restraint on budgetary deficits. More than a dozen states must operate under tax or spending limits. After election day 1980, the number will reach or surpass several dozen. Future increases in state and local taxes or spending will be linked to increases in such indicators as personal income, the CPI, or population increase.

The new limits on spending or taxing mean that state and local governments cannot practice deficit finance or raise new taxes to pay for new spending programs. If inflation, coupled with progressive personal income tax rates, increases state revenues more rapidly than personal income or the CPI, taxpayers in those states will enjoy tax refunds or cuts in tax rate schedules, subject to provisions regarding accumulated budgetary surpluses.

Economic circumstances vary widely across states, and, as we have seen, tax and spending limits assume a variety of forms and extremes—no one limit fits all circumstances. Nor is it necessarily desirable that standardization should be imposed.

Still, the trend of tax or spending limits raises some general questions. As in California, Proposition 13-type property tax limitations may lead to state funding as a substitute for reduced property tax collections. But the catch is the accompanying prospect of greater centralization, with possible loss of local autonomy. This prospect troubles enthusiasts of local democracy and community control. Unless state assistance is free of strings (for example, block sharing of sales taxes with local government, without categorical stipulations), local influence and authority may wane.

Curiously, the concern about autonomy of state and local governments has not prevented or even slowed the enormous increase in intergovernment grants. Federal grants-in-aid to state and local governments have grown from the modest total of $7 billion in 1960 to $80 billion in 1980. Federal grants to state and local governments are equivalent to 32 percent of locally collected tax receipts and have doubled in the past twenty years. The rhetoric calls for state or local autonomy; in reality localities seek more state aid and the states, in turn, more federal aid.

What is the likely impact of spending or tax limits on shared government programs? Some say that spending limitations will force financially strapped local governments to maintain their grant-in-aid matching money and further cut their support of conventional services. Others say that the effects will be minimal because local governments share state and federal priorities. Moreover, should the federal government maintain current levels of aid to states and cities that voluntarily cut their expenditures for matching funds?

The entire system of intergovernmental grants rests on the premise of continued public sector spending; it was not designed to work smoothly in an era of declining state and local government spending. We are thus likely to see greater attention to analyzing the impact and equitability of intergovernmental grants and matching funds. We will also see increased pressure on the states and federal government to pay the full costs of programs and policies imposed or initiated from above. Indeed, the entire system of intergovernmental grants will be called into question, especially if a tax or spending limit becomes national law.

Trends at the national level are more difficult to forecast. However, only the federal government has the power to print money and sustain indefinite budget deficits.

The congressional movement to eliminate budget deficits should continue to grow. As of April 1979, some 238 lawmakers sponsored either constitutional amendments or laws requiring the government to balance its budget except in time of war or other national emergencies. Another 108 senators and representatives, led by Congressman Jack Kemp and Senator William Roth, proposed a 30 percent tax cut over three years, equal to about 170 billion dollars. Still another 131 lawmakers favor an automatic adjustment of tax brackets each year to account for inflation.

However, no one issue dominates national politics for long. If the number of states calling for a constitutional convention fails to reach 34, Congress will probably continue to hold hearings and talk of the need for

a balanced budget or spending limitation, but is unlikely to do more than deliberate. But as the 34th state prepares to pass a resolution, Congress will move with alacrity to offer its own amendment. Thus, the movements to limit taxes and spending are more likely to succeed at the state than the federal level.

RECOMMENDATIONS FOR THE 1980S

Most states have some limitation on deficit finance. However, these bans have not prevented a steady growth in state spending and taxes. Tax or spending limits are necessary to halt, and perhaps reverse, the trend to increased government spending.

Every state should enact a statute or constitutional amendment that links increases in taxes or spending to an appropriate measure of individual economic gain. These measures should include procedures for emergency overrides, but by no less than a two-thirds vote of the state legislature or of the voters in a local jurisdiction. (Gann's proposed "Spirit of 13" amendment is an excellent model.)

At the same time, to cut taxes and spending without cutting public services, the following strategies can be adopted.

1) Let users pay. This policy puts the burden of support for services on users, rather than on taxpayers in general. It therefore cuts costs by discouraging casual use of limited resources. This policy would apply to recreation programs, parks, golf courses, camping permits, swimming pools, libraries, cemetaries, housing developers, utility fees, airport fees, bridge and ferry tolls, school lunch charges, and other areas. Consumers of these "public" services pay privately for bowling, movies, and other recreational activities. There is no reason why many more publicly provided services cannot be supplied on a commercially viable basis. The general principle of charging for a commodity what it costs ensures that someone who is content with an economical supply of it does not subsidize someone else who wastefully luxuriates in it.
2) Contract for services. Increasingly cities and counties have realized tax savings by turning to outside contractors. A study completed at the Columbia University Graduate School of Business found that refuse-removal firms under contract to medium-sized cities cost nearly 30 percent less than similar public municipal programs. Another example is the innovative fire service protection based in Scottsdale, Arizona; a private company services thirteen communi-

ties at about half the expense of neighboring fire departments of equal quality. Urban landscape maintenance costs in Lynwood, California, fell by one-third when a private landscape firm took over tree trimming from the city.[10]

Other examples of contracting out include food preparation (fast-food franchising) in high school cafeterias, data processing for government records, security guards for public buildings (at lower cost than municipal police), golf course maintenance, vocational education, child day-care (which has been provided in Dade County, Florida, for half the per capita cost of county services), maintenance of municipal vehicle fleets, and even private provision of bustop shelters (which derive their revenue from the sale of advertising space). In the past decade, perhaps 500,000 municipal jobs have been transferred from the public to the private sector, at great savings to taxpayers.

3) Fund mandated services through the state. This strategy requires a state to fund, from within the state's spending or taxing limit, the total cost of programs it mandates on local governments. Otherwise, a state could shift spending to local units of government and thus free funds for new spending programs without violating the limit. Local governments would then have to raise new taxes (unless the limit applied to each unit of local government as well) or cut back services that residents may value more highly than those imposed by the state.

4) Emphasize private substitution. There is no inherent reason that Americans should look to government for those goods and services that can be individually acquired. For example, each of us can make a more determined effort to install double dead bolt locks, smoke alarms, and fire extinguishers and take other preventive measures to reduce security or fire risks. These private actions and expenditures may be more effective than spending a similar number of dollars in public police and fire programs.

There is no reason that individuals cannot provide for their own recreational activities, education, medical care, and housing and pay utility rates that fully support the cost of private provision. Of course, at least for the foreseeable future, that small minority of Americans whose limited incomes preclude some minimally acceptable level of consumption of basic goods and services will remain. But the current mix of welfare and income transfer programs addresses this community of people. It is neither necessary nor appropriate for the general taxpayer to support the provision of

goods and services that the overwhelming majority of Americans can afford to provide for themselves.

At the national level, I recommend that Congress propose the following constitutional amendment, which requires a balanced budget and limits federal spending:

A PROPOSED CONSTITUTIONAL AMENDMENT TO BALANCE THE FEDERAL BUDGET AND LIMIT FEDERAL SPENDING

Section 1. To promote responsible fiscal and monetary policies, the government of the United States shall be required to balance its budget.

a) Total outlays in any fiscal year shall not exceed total revenues. Total outlays shall include budget and off-budget outlays and exclude redemptions of the public debt and emergency outlays.

b) When, for any fiscal year, total revenues received by the government of the United States exceed total outlays, the surplus shall be used to establish a reserve fund up to but not exceeding 5 percent of total annual outlays, which may be used to cover a temporary deficit in any one year. All other surplus revenues beyond this 5 percent reserve fund shall be used to reduce the public debt of the United States until such debt is eliminated.

c) To permit orderly implementation, the requirement for a balanced federal budget shall be phased in over a period not exceeding four years, beginning with the first fiscal year following ratification. Any deficit on that date shall be reduced by no less than one-fourth in each of the four succeeding fiscal years.

Section 2. To protect the people against excessive governmental burdens, total outlays of the government of the United States shall be limited. Total outlays in any fiscal year shall not increase by a percentage greater than the percentage increase in nominal gross national product in the last calendar year ending prior to the beginning of said fiscal year.

Section 3. Following declaration of an emergency by the president, Congress may authorize by a two-thirds vote of both Houses a specified amount of emergency outlays in excess of the total outlays limit for the current fiscal year, and it may suspend for that emergency period the balanced budget requirement by a specified amount in excess of the reserve fund described in Section 1b.

Section 4. The government of the United States shall not require that state or local governments engage in additional or expanded activities without compensation equal to the necessary additional costs.

Section 5. The Congress shall enact all necessary legislation to implement this article.

Section 1 mandates a balanced budget and limits total federal outlays to federal revenues. The amendment aims at attaining a balance over a period of years; it is somewhat flexible on a year-to-year basis. The principle of the annuality of revenue and expenditure estimates is necessary if the Congress is to exercise its responsibilities and powers, but it is wrong to look strictly at each year separately. On average, taxes and spending should even out, and the existence of reserves should permit steady implementation of agreed-on programs in the event revenues fall short of projections. Note finally that the requirement of balance is phased in over a gradual period to minimize disruptions in the conduct of the public finances.

Section 2 follows the Heinz-Stone amendment and limits increases in spending to the percentage increase in GNP of the calendar year preceding any fiscal year.

Section 3 allows the president and Congress to suspend the balanced budget and spending limit provisions for one year. Simultaneous conduct of the Vietnam War and the Johnson administration income transfer programs could not have been possible under this amendment without three successive declarations of emergency. An explicit declaration of emergency, in turn, may have restrained the massive deficits or wartime spending between 1966 and 1968 and stimulated public debate on these two important national policies.

Section 4 prevents the federal government from circumventing a constitutional spending limit by mandating that states or local governments engage in new or expanded activities without full federal funding. Finally, Section 5 leaves to the Congress responsibility for enacting legislation to implement the details and procedures of the amendment.

The proposed amendment is, I think, not so long as to clutter the constitution, but sufficiently detailed to ensure consensus on its meaning.

If my proposed amendment is adopted, federal finances would be conducted in the same manner as in those states with both balanced budget and spending limit provisions. The balanced budget requirement means that new spending programs must be funded by levying new taxes or by terminating old spending. It also means that federal budget deficits will no longer be the inflationary force they have been since the mid-1960s.

But since a balanced budget clause does not prevent government spending as a share of national output from rising (as has taken place in many states), only the inclusion of a spending or taxing limit ensures that the size of government can be stabilized (perhaps decreased), save in emergency years. Together the two provisions will compel fiscal responsibility on the part of the federal government for the first time in

50 years. It is the American people who will benefit in the decade of limits—the 1980s.

NOTES

1. The title of this section is taken from Roger A. Freeman, *The Growth of American Government* (Stanford, Calif.: Hoover Institution Press, 1975).

2. These totals are calculated from the *Economic Report of the President 1979* (Washington, D.C.: Government Printing Office, 1979): Table B-69, p. 263.

3. See Michael J. Boskin, "Some Neglected Economic Factors Behind Recent Tax and Spending Limitation Movements," mimeographed (December 1978).

4. *Public Opinion*, July/August 1978, pp. 29–31.

5. For a history of California's experience with property tax reform and spending limits, see Frank Levy and Paul Zamolo, "The Preconditions of Proposition 13," Urban Institute Working Paper 1105–01 (October 1978), pp. 4–17.

6. See William H. Oakland, "Proposition 13: Genesis and Consequences," *Economic Review of the Federal Reserve Bank of San Francisco*, Winter 1979, pp. 7–24.

7. Mervin Field, "Sending a Message: Californians Strike Back," *Public Opinion*, July/August 1978, pp. 3–7.

8. *Limitations on State Deficits* (Lexington, Ky.: Council of State Governments, 1976).

9. *AEI Economist*, April 1979, pp. 4–6.

10. Mark Frazier and Jim Lewis, "New Ways to Cut Your Local Taxes," *Readers Digest*, March 1979, pp. 159–62.

WHY WE NEED A CONSTITUTIONAL AMENDMENT TO LIMIT FEDERAL TAXING AND BALANCE THE BUDGET

Statement before members of the Senate Judiciary Committee

May 29, 1981

Phoenix, Arizona

by

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Introduction

My professional research interests have long concerned the subject of the budgetary process, of the relationship between revenue and government spending, and growing public clamor for limits to taxation and spending. My interests range across state and local government, the federal government, and several foreign countries. I have written two books about the fiscal practices of the Hong Kong Government, where balanced budgets and financial reserves--not deficit spending and public debt--are the rule, and several papers on the reduction of government spending and taxing in Great Britain during the nineteenth century. I am presently completing a book on the impact of Proposition 13 on both the public and private sectors in California and the various tax and

spending limitation measures in the several states. I have been watching with great interest the competing proposals that have been advanced to limit federal spending or taxation. I therefore welcome this opportunity to present my thoughts on the prospects of a constitutional amendment that might limit taxes and spending or require a balanced budget.

The Budgetary Process

What is the essence of a budgetary system? The function of any government budget, as I understand it, is to compare estimates of proposed expenditure with past spending, current appropriations, and the resources available with which to meet the proposed new spending. The essence of a budget is that the fund-raising and granting authority (e.g., Congress, a state legislature, a local government) shall be presented with a consolidated statement of estimated receipts and expenditures in order to show a net position of balance or a prospective deficit or surplus--which in turn may either permit a reduction of taxation or require an increase in taxation or other funding.

Throughout most of our history, and that of many Western nations, revenue estimates were typically dealt with before expenditure estimates. It was generally believed that public expenditure should be fit to available public revenues, and that revenues should not be extended to fit expenditure. Moreover, public debt was regarded as undesirable, a thing to be reduced and eliminated if possible. The guiding principle was that government should aim to be self-supporting--this implies a philosophy and practice of balanced budgets.

In the twentieth century, spending decisions have become increasingly divorced from constraints of revenue. The government now determines its spending priorities first, and then instructs the Treasury to get, by taxation or borrowing, whatever funds are necessary to cover the outlays. Since government is reluctant to vote explicit tax increases,

borrowing has been an important way to cover shortfalls. The result has been an accumulation of massive public debt and rising rates of inflation induced by rapid monetary growth.

Deficits

Large and accumulating budget deficits make the job of limiting monetary growth more difficult. Although federal deficits have long been characteristic of the United States, their size and persistence have expanded. In the decade 1955 to 1965, the cumulative federal deficit amounted to only $31 billion. In the next decade the cumulative total was $148 billion. Between 1976 and 1980, the deficits amounted to some $275 billion, all in normal, peacetime circumstances.

For fiscal year 1981, the national debt will surpass $1 trillion. This sum is equal to $4,400 for every man, woman and child in America, or $17,600 for a family of four. Interest on this debt alone is projected at $100 billion, or $440 per capita. Interest payments comprise the third largest item in the federal budget, consuming about a dime of every budget dollar. A good deal of these budget deficits are financed the politically easy way by creating new money at the Fed, with the inevitable effect of more subsequent inflation.

Professor Allan Meltzer, in a previous contribution to the issue of balancing the federal budget (Congressional Record, August 16, 1978), noted "The greater the amount of money issued to finance the deficit, the higher the subsequent inflation. The principal reason deficits lead to inflation is that the deficits are often financed by printing money."

In short, federal budget deficits have fueled inflationary increases in the money supply. Between 1947 and 1967, an era of modest budget deficits, the inflation rate averaged just 1.6 percent; in contrast, the average rate from 1967 to 1977 was 7 percent, accelerating to 9 percent in 1978. In the last two calendar years, inflation has run at 13.3 and 12.4 percent, respectively, the first time in 60 years we

have endured double-digit inflation in back-to-back years. An additional consequence of deficits is that borrowing by the Treasury to finance them to some extent usurps funds from private financial markets.

Growth of Government

That government spending has grown dramatically in this century is beyond doubt. Total spending has risen from 8.0 percent of Gross National Product in 1902 to exceed 34 percent in 1980. Federal spending alone has risen from 2.7 percent of GNP in 1902 to exceed 22 percent in 1980, an eight-fold increase. Federal taxation as a share of GNP has similarly risen. Ironically, some of this growth is due to the income tax receipts made possible by the 16th Amendment. Indeed, current debate on the need for an amendment to limit taxation is partially attributable to the 16th Amendment.

Thus, in the absence of an effective limitation on government taxing and spending, we can say that our political processes contain a strong systematic bias to increase those amounts. It is relatively easier to accede to new demands for spending than to cut back on existing programs. Inflation coupled with progressive taxation has provided the revenues to finance more spending.

Until 1973, the growth in government spending and taxing was accompanied by a steady rise in real, after-tax income. Since 1973, growth in real private income has fallen off dramatically. As a result, the public is increasingly concerned about its rising tax burden.

Why a Balanced Federal Budget?

Proponents of a balanced budget amendment couch their support in normative, economic, and political terms. The moral benefits of a balanced budget are not to be overlooked. A balance between taxing and spending means that society must live within its collective means. A balanced budget is analogous to the financial circumstances of an

individual household or firm. The balanced budget thus conceptually links governmental finance and the average family's budgetary practice.

A balanced budget amendment would solidify the link between spending and revenue. It would compel public officials to determine first what resources are available to government and, against that constraint, choose among the many competing claims on public spending. It would ensure that the people know exactly how much it will cost in terms of taxes to finance federal programs. An amendment is deemed necessary because such modest reforms as the Congressional Budget Act of 1974 only marginally curbed the federal government's propensity for deficit financing.

Most important, a prohibition of deficits will eliminate that pressure on inflation. It will, as well, contribute to price stability and to increased spending by the private sector, increase after-tax returns to capital and labor, strengthen the dollar in foreign exchange markets, and prevent massive new outbreaks in spending except in emergencies. A balanced budget will be excellent therapy for national inflationary psychology; it will help end the bias toward borrowing and spending.

Under the amendment, if politicians voted new spending programs, they would have to eliminate old programs or raise additional taxes. Resistance to the elimination of existing progams or to tax increases would discourage many new spending proposals and eliminate the current bias towards overspending. It would end future deficits and eliminate the inflationary effect of new money creation, which has in past years financed these deficits.

Although some regard any tax increase as inherently undesirable, a balanced budget amendment still permits an increase in public spending if there is an overriding democratic consensus. In practical terms, however, and in the current era of tax revolts, few politicians will want to campaign on a platform of higher taxes to finance more spending. The balanced budget will require that tax increases be explicitly voted

rather than implicitly imposed by deficit spending and inflation--this will effectively constrain new government spending.

Political values and perceptions are important determinants of government action. For this reason, a balanced budget amendment is especially attractive. It is easy to understand--every housewife understands the need for living within her means. It is also widely supported. Polls show overwhelming support for a balanced budget, often by margins of six-to-one.

Why a Limit on Federal Taxes?

Proponents of tax limits want to offset the inherent bias in our current tax system toward higher and higher taxes. Our progressive tax code works to transfer more and more of our personal income to the government, because as individual income increases, people are taxed at progressively steeper rates. This rising share of national income paid in taxes occurs due to "real" increases in income or due to inflation, because in both cases taxpayers pay an increasingly higher percentage of their marginal earnings in taxes. This tax system allows Congress to raise taxes without ever having to vote an explicit increase in taxes. Indeed, the progressive tax system has permitted Congress to enact seven major postwar tax reforms (the eighth is now under consideration) and still collect an ever larger share of our income in tax receipts.

Of course, Congress long ago could have corrected for the inflation-generated tax increases by indexing, but this would have removed from elected politicians the discretion to claim credit for tax cuts. (See my attached article "The Attractions of a Flat-Rate Tax System," Wall Street Journal, March 25, 1981).

Eliminating inflation would reduce tax increases due solely to inflation-generated "bracket creep." But economic growth also pushes taxpayers into higher tax brackets, unless Congress periodically votes offsetting reductions.

Thus the need for some form of tax limitation is readily apparent. It restores balance to the budgetary process by neutralizing the automatic tax increases that now occur without voting. It permits a rise in taxation, only if Congress so explicitly votes.

The War of American Independence was fought against an unjust British King and Parliament on the simple theme of "No taxation without representation." A constitutional tax limit insures "No tax increases without voting."

Conclusion

Critics argue that the constitution should remain free of any amendment that concerns economic policy. I believe this view is somewhat narrow. The founding fathers took limited government for granted, a fundamental principle of the American constitution. Indeed, direct taxation of income was permitted only after the 16th Amendment was ratified in 1913.

I believe that the founding fathers could never have contemplated this century's dramatic growth in taxing, spending, and public debt. If they had thought possible that the limited government they created two centuries ago could ever grow to is current size, with its overbearing presence in virtually every aspect of economic life, I believe they would have provided either for some limit on spending and taxing and required a balanced budget, save in emergency circumstances. They did not because they regarded today's government as inconceivable.

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The Attractions of a Flat-Rate Tax System

By ALVIN RABUSHKA

President Reagan has promised us a tax cut worth $30 billion to $40 billion in 1981. The centerpiece of his program, Kemp-Roth, would reduce personal income tax rates across-the-board by 10% a year for three years. Also, business depreciation would be accelerated to speed capital recovery. Is this tax package really the "tax cut" supply-siders have been working for?

The Reagan proposals represent the eighth in a series of congressional tax bills dating from 1954. Each bill was intended to offset the cumulative tax increases arising from the progressive structure of our tax system, intensified by inflation.

Federal tax receipts as a share of GNP have ranged from a low of 15% in 1949, following substantial postwar tax cuts, to a high of 21% in 1969, reflecting the Vietnam war. Beginning with the recodification of the tax laws in 1954, Congress passed further tax "reform" measures in 1964, 1969, 1971, 1976, 1977 and 1978. The accelerating frequency of congressional action reflects an exponential increase in the inflation rate.

The years of major tax cuts—1954, 1964, 1971 and 1976—show sharp reductions in tax receipts as a share of GNP. But the sequence of tax measures has not benefited all taxpayers equally, since the bulk of relief in dollar terms has gone to lower- and lower-middle-income households in the form of greatly increased personal exemptions and standard deductions. In postwar tax reform, rate reductions, either across-the-board or for upper-income households, have been more the exception than the rule and increasing numbers of taxpayers face higher and higher marginal rates.

Of course, Congress long ago could have corrected for the inflation-generated tax increases by indexing, but this would have removed from elected politicians the discretion to claim credit for tax cuts. A once-and-for-all indexing bill would only give politicians a once-and-for-all credit.

Congress's Joint Committee on Taxation has estimated, assuming an effective date of Jan. 1, 1981, that bracket-creep-induced tax increases in 1981 would offset 86% of the total dollar value of tax relief contained in Kemp-Roth, 72% in 1982 and 68% in 1983. Of course, if the inflation rate is higher than that contained in the joint committee's projections, the tax reduction in Kemp-Roth will be even smaller. Because Kemp-Roth is now proposed to take effect in July 1981, the tax cut is smaller still.

If the Reagan administration had been serious about tax cuts, it would have stuck with its original plan to first index the brackets and then cut the rates for a "real" tax reduction. This would put an end to a sloppy, inefficient substitute for indexing. The real issue is whether the adjustment of income taxes for inflation is to be automatic and continuous—with indexation—or discretionary and discontinuous.

Indexing would solve the bracket-creep problem. But it still would leave us with an inefficient tax system. For example, a flat rate of 11% on all personal income would bring in about as much revenue as the current 14% to 70% scale with its thousands of loopholes. If we want to retain some of the deductions from personal income currently in force, the flat rate need be only 15% of adjusted gross income (which would put an end to standard or itemized deductions). And even if we want to retain all of our present exemptions and deductions, a flat rate of 18% on taxable income would suffice. This latter rate would still exclude the very poor from the income tax net.

The benefits of a low-flat-rate tax system would be to stimulate individual initiative and economic growth. It would simultaneously reduce the incentives for barter, tax avoidance shelters and underground economic activity.

The tax base would widen and revenues would in all likelihood increase, thus permitting a further cut in tax rates. The government would raise all the revenue it needs to pay for current programs without penalizing or discouraging anyone from additional work. And, of course, there is "automatic indexation" with a flat-rate system, since inflation increases tax revenues and the tax base in proportion.

In this session Congress is likely to adopt some or all of Kemp-Roth and the administration's other tax cut proposals. Adoption of a low-flat-rate tax system is still very much in the future. But there is growing consensus that progressive taxation adversely affects the incentives to work, save and invest, thereby slowing economic growth. Perhaps the whole system of progressive taxation has outlived its usefulness.

Several Senators and Representatives are considering introducing bills in the next few months proposing a flat rate in place of the current progressive system. While only a first step, it nonetheless is a significant one in the movement to obtain a real supply-side tax system.

Mr. Rabushka is a senior fellow at the Hoover Institution of Stanford University and served as a member of President Reagan's tax policy task force.